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THE FINANCIAL OUTLOOK OF THE U.S. POSTAL SERVICE

HEARING

BEFORE THE

COMMITTEE ON
GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

ONE HUNDRED SEVENTH CONGRESS

FIRST SESSION

MAY 15, 2001

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THE FINANCIAL OUTLOOK OF THE U.S. POSTAL SERVICE

TUESDAY, MAY 15, 2001

U.S. SENATE,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, DC.

The Committee met, pursuant to notice, at 10 a.m., in room SD–342, Dirksen Senate Office Building, Hon. Fred Thompson, Chairman of the Committee, presiding.

Present: Senators Thompson, Carper, Cochran, Stevens, Collins, and Carnahan.

OPENING STATEMENT OF SENATOR THOMPSON

Chairman THOMPSON. Let's come to order, please. I want to welcome everyone to the Committee on Governmental Affairs this morning, our hearing on the financial outlook of the U.S. Postal Service, along with Senator Cochran and his Subcommittee, who have done so much fine work in this area. We are here this morning because of our increasing concern over the financial condition of the Postal Service. The Committee welcomes our witnesses, Comptroller General David Walker, Postmaster General William Henderson, Postal Service Board of Governors Chairman Robert Rider, and Postal Rate Commission Vice Chairman George Omas. I hope our assembled panel can shed some light on the course the postal finances have taken over the past year.

While we will discuss many aspects of this problem in hopes of achieving a better understanding of the reason for the current situation, certain things seem to be clear. The Postal Service framework, established by Congress in 1970, appears to be near a breaking point. We established a system whereby the Postal Service would have the characteristics of a Federal agency and the characteristics of a business enterprise. On the one hand, we require that the Postal Service provide universal service to every home and business in America. We give them little control over the rates they charge and their labor cost. We require that they leave unprofitable post offices open. We leave them open to the swings in the economy, along with fluctuations in transportation and fuel cost. Finally, we require them to break even.

On the other hand, we provide the Postal Service with an absolute monopoly on the delivery of letter mail. We provide that they do not have to pay taxes or be subject to antitrust laws, the way that businesses are. This system worked for several years. However, circumstances changed. Two trends developed that changed the face of the Postal Service. First was a technological revolution,

which is in the process of changing the way in which people communicate with each other. That technology is rapidly finding business applications in all aspects of society.

The second change was that the Postal Service eventually and inevitably began to take on the characteristics of most Federal agencies. It continued to grow without a focused strategic plan. It developed serious financial management problems, including wildly fluctuating projections of cost and income. It is unable to utilize technology to increase its efficiency and productivity even after spending billions of dollars. It wastes tremendous sums of money due to mismanagement. A combination of these factors results in the difficulties that we see before us, as laid out by the GAO—billions of dollars in deficits in the coming years and an inability to deliver the services we want and costs that are sustainable.

Clearly, the Postal Service must address its productivity and its management issues. An 11 percent growth in productivity over the course of 30 years is not good, to say the least. Reports by the Postal Service Inspector General of $1.4 billion in waste and mismanagement fuel further cynicism about agency operations. Just as clear, however, is the recognition that Congress must revisit the 30-year-old statutory framework under which the Service now operates. As we proceed, we must ask ourselves some pointed questions.

We, in Congress, must ask what services we want the Postal Service to provide and what price we are willing to pay for them, and do we really expect the Postal Service to hold costs at a reasonable level when we are mandating so many things that make that impossible. The Postal Service must ask itself if it really expects reform that gives it more discretion when it has not demonstrated the ability to make financial projections, hold down costs, or increase productivity. Stakeholders should ask themselves, even though they may be more comfortable under the current situation, where will they be if the Postal Service falls apart?

I approach this issue with no preconceived notion as to the precise measures that should be taken. There is a lot that we need to understand about the nature of this problem. However, it is my belief that nothing should be left off the table, including the future of the postal monopoly itself.

Senator Carper.

OPENING STATEMENT OF SENATOR CARPER

Senator CARPER. Mr. Chairman, thank you very much. To our witnesses today, welcome. It is nice to see some of you again. One of you looks really familiar. Mr. Rider, where are you from?

Mr. RIDER. Rehoboth Beach, Delaware, sir.

Senator CARPER. A lot of people who work over in this part of the country are going to be heading for your hometown in about 2 weeks, when Memorial Day weekend is upon us. We look forward to seeing some of you this summer, and as they make their way to Rehoboth Beach, they can go through Bridgeville, where I believe your business is, for the Apple-Scrapple Festival later this year. That is a great combination, as I am sure you can tell everybody. I understand your testimony focuses on that very thing. We are really pleased to see you here—you and I used to be the same

thing. We use to be governors together, and now you are chairman of the governors, and I am just a former Governor, but we are delighted that you are with us.

To our other witnesses today, Mr. Henderson, I understand you are going to be stepping down as Postmaster General after several years of Service, and I just want to say publicly, thank you for your work and your leadership of the men and women who are part of the Postal Service.

Mr. Walker, we look forward to being with you here today. Your people are doing great work, and we are looking forward to your comments.

Just a couple of quick comments. I really look forward to your comments and to the give and take that we have here today. Mr. Rider and I had a chance to chat on the phone not too long ago about a couple of things, and as you look for ways to raise revenues and to hold down your cost, I would again urge you to focus on workplace safety. The cost that I think we discussed on the phone was about $1.5 billion, and some of that is hard to control. Some of that is more easily controlled. We talked a bit about the good work that has taken place at Alcoa, under the leadership of the fellow who is now our Secretary of the Treasury. We talked a bit about, closer to home, the work that goes on at the duPont Company, where my wife works, and a lot of other Delawareans work, as well, and stay focused on workplace safety to help to drive down their cost.

I understand that is a focal point, but as you look for Mr. Henderson's successor, I sure hope that you will keep in mind it would be great to have a leader who understands how much money actually could be saved, is being saved, and could be saved. The other thing I would say is my hope is, as we go through our testimony today, we will have the opportunity to find out some ways that you are raising revenues, would like to raise revenues, and ways that you are raising productivity and would like to raise productivity, some ways you are trying to hold down your costs and would like to further hold down your costs.

What I am looking for are ideas where we can be a partner, where we can help to assist you in those efforts and ultimately provide better service to the folks that we represent. Again, I am glad that you are here and we look forward to this give and take. This is an important hearing for everybody in every State, and we thank you for joining us today, especially Mr. Rider, who I think may have been in Hawaii visiting his daughter, and it was good of you to come back here. We have offered you some great weather, so you should not be complaining, my friend. But we thank you for making this trip and we apologize for disrupting your plans with your family.

Chairman THOMPSON. We are holding our hearing today in conjunction with Senator Cochran's Subcommittee, so I will call on Senator Cochran next for any comments.

OPENING STATEMENT OF SENATOR COCHRAN

Senator COCHRAN. Mr. Chairman, it is a pleasure to join you this morning in convening this hearing. We think it is an important and timely hearing. There are all kinds of suggestions even being

made in advertisements in the *Washington Post* this morning about what the Postal Service needs to do to get its house in order financially, and to turn a profit rather than a deficit, and therefore obviate the need for a postal rate increase. It would be good to hear the witnesses' reaction to that suggestion.

I think the underlying message is that the Postal Service has too many people and it can solve all its problems by cutting down the number of employees it has. That will be an interesting thing for you to respond to, as well.

Mr. Omas, it is a pleasure to recognize you, specifically. What State are you from?

Mr. OMAS. Mississippi.

Senator COCHRAN. I just wanted to be sure I remembered that right. Who was your dormitory manager when you were at Guess Hall, at the University of Mississippi?

Mr. OMAS. I think his name was Thad Cochran. [Laughter.]

Senator COCHRAN. It is good that you remembered all that, as well, and we look forward to visiting with you further on these issues.

Thank you, Mr. Chairman.

Chairman THOMPSON. All right.

Mr. Henderson, where did you used to be a postmaster?

Mr. HENDERSON. Memphis, Tennessee. [Laughter.]

Chairman THOMPSON. Beg your pardon?

Mr. HENDERSON. Memphis, Tennessee.

Chairman THOMPSON. That's what I thought you said. [Laughter.]

Chairman THOMPSON. While we are at it, Senator Stevens?

Senator STEVENS. Mr. Henderson, what State have you spent more time in, in the last 5 years?

Mr. HENDERSON. Alaska. [Laughter.]

OPENING STATEMENT OF SENATOR STEVENS

Senator STEVENS. Mr. Chairman, I am delighted that you are having this hearing. I have three going on this morning, but I did want to come and participate here, particularly to thank again the Postmaster General for his service. I have worked with all the gentlemen at the table, but Postmaster General Henderson has come to Alaska quite often to try and see what we can do to solve the problems of postal delivery and the deficit that they run up there, which is a matter of necessity, and that is one of the reasons I am here.

We have no roads. There is only one main road in Alaska. Seventy-five percent of our transportation of goods is by air, and that is primarily by parcel post. The system that the Constitution guaranteed for maintenance of post offices and post roads has real meeting in my State, and Postmaster General Henderson, you have recognized that and we appreciate that. Beyond that, I came because I listened to the statement of the Chairman and I have great respect for him, but I hope he would keep in mind that it is 30 years ago now that I tried to get the Post Office to be involved in something that we now call E-mail. This Committee decided that was not proper. That was a system that was going to grow in the private sector, and it was probably a good decision, because it has

grown very well. But it competes highly with the Postal Service, and I do not think that the monopoly and the printed word is one thing. I do not think the Post Office has a monopoly anymore in terms of mail.

But that is a generational thing, and I would hope you keep that in mind. It is an urban thing. The capability of my people to go on the Internet is not yours, because we automatically changed long distance rules. Intrastate calls in Alaska are long-distance calls. Our competition here is with the printed word and the generational concept that I mention to you is in an aging population, and our population is aging. The majority of those people who are aging are not computer capable, and they are still dependent upon this postal system.

I am going to oppose any radical change in the Postal Service until we are assured that the access is not limited to the younger generations, in terms of capability to communicate. Just think of it. All of you can think about it. The mail you primarily get, the personal letters you primarily get today, if you are computer-capable, are from your relatives that are my age. Now, I happen to be fortunate and communicate with my children by E-mail. But not many people do that, and I think we have to keep in mind this postal system must be maintained to deliver the printed word, so long as a substantial portion of the population is dependent upon that service.

I know that there are losses out there. I know that there are things that can be changed. But every year we look at a deficit in the Postal Service revenue for our State, and you all know it is there, and I know it is there, but the difference is if you want to eliminate it, then give us about $3 billion a year to build roads, and remove the opposition in the environmental community to building those roads.

That is the same in other areas of the country, particularly the rural areas of the country, that do not have access to the Internet, at least equal access to the Internet. On another Committee, we are working on this concept, Mr. Chairman, of equal access to the Internet, and I believe the day will come when the printed word, as far as personal communication, will be gone. But until that day comes, the Postal Service will be our way of complying with the Constitution; and I hope we all keep that in mind as we look at this.

Mr. Walker, I am interested in your report, and I am not criticizing the report, but I think some of the things that are analyzed as being losses are expenses of being involved in a business that is not bottom-line cost effective. So I hope we can keep that in mind. Again, I welcome you all and I thank you for the courtesy, because I have to go to another meeting. Thank you very much

Chairman THOMPSON. Thank you very much.

Senator Collins.

OPENING STATEMENT OF SENATOR COLLINS

Senator COLLINS. Thank you very much, Mr. Chairman.

Gentlemen, which State would you most like to spend August in? [Laughter.]

After Senator Stevens leaves, I can get a unanimous answer of Maine from each of you.

Mr. Chairman, I have a lengthy statement which I would like to submit for the record in the interest of time.

Chairman THOMPSON. It will be made a part of the record.

Senator COLLINS. I just want to say that I am troubled by how quickly the financial picture of the Postal Service has darkened. It was only in February 2000 that the Postal Service still had a net income of $1 billion, and yet now we are seeing projections of very significant losses, and I am further troubled that the first response to those losses is to seek higher rates, to look at eliminating Saturday delivery, and to look again at closing small post offices, which, in many parts of my State, are absolutely critical and are truly the heart of a community.

So I look forward to exploring these issues with our witnesses today. The Postal Service in Maine, as in Alaska, is absolutely critical. We need to maintain the universal service requirement, and I am very concerned about the financial stakes that we now face. So, Mr. Chairman, I would put my statement in the record, and I look forward to hearing from our witnesses.

[The prepared statement of Senator Collins follows:]

OPENING PREPARED STATEMENT OF SENATOR SUSAN M. COLLINS

Thank you, Mr. Chairman.

The U.S. Postal Service has origins that predate the birth of the United States itself. In 1775, the Continental Congress appointed Benjamin Franklin as the first Postmaster General. The value of a national postal service was so apparent to our nation's founders that the power to establish post offices and roads comprises one of only 18 clauses of legislative authority explicitly granted to Congress in our Constitution.

This is not to say, Mr. Chairman, that the Postal Service has not changed with the times. Under congressional statute, it expanded service via navigable waterways in 1823 and the railroads in 1838. Airmail followed as early as 1918. The Postal Service apparently even experimented with an even more spectacular form of delivery—"missile mail"—in 1959. Though missile-borne cross-country mail proved rather less successful than other forms, the episode certainly demonstrated the Postal Services' willingness to try new innovations.

Another, far more successful Postal Service innovation occurred in 1863: the institution of universal postage rates without regard to distance. This system would eventually allow all Americans to reach out to one another easily and effectively, regardless of where they lived or how far the mail had to travel. For a short journey or a long one, the Postal Service would charge a single, affordable rate. Even in the middle of a terribly destructive and divisive civil war, the Postal Service recognized that we were one nation and took important steps to help bring that nation together as one. Combining this single-rate service with its near-universal penetration of the American countryside, the Postal Service helped knit together the nation we know today.

Since 1971, the Postal Service has been organized as a separate entity, albeit one different than any other government agency. As such, it receives no general fund revenues. Instead, it relies upon sound business practices and a watchful Board of Governors to ensure that it carries out its mandate to deliver the people's mail in a convenient, efficient and uniform manner.

Still, much has changed in the three decades since we established the modern United States Postal Service. The advent of new technologies has proven to be a special challenge to the fulfillment of the Postal Service's traditional role. Recently, a confluence of factors ranging from high gas prices to the advent of E-mail and electronic bill payments have caused some to question whether the Postal Service can continue to do "business as usual."

From September of last year through this February, the Postal Service lost $260 million. Today, the Service estimates it may lose between $1.6 billion and $2.4 billion for this year, and perhaps even more in 2002. These trends, therefore, call into

question the Postal Service's ability to continue to provide its current level of services at uniform prices and reasonable rates. Alarmingly, the Postal Service has accumulated so much debt that it is now approaching its statutory borrowing limit of $15 billion.

Many Postal Service stakeholders have told Congress that the Service needs changes in the law to allow it to be more efficient in its pricing, labor relations, and financing operations. GAO recently testified that the USPS had increased its efficiency by only 11 percent over the past three decades—during a time in which the productivity of the private sector has been exploding.

To cope with these its tremendous problems, the Postal Service is considering a reduction of core services—including the closing of smaller postal facilities and the elimination of Saturday mail delivery. At the same time, however, it continues to carry on *non-core* services, such as E-commerce operations, that we are told lose substantial sums of money.

According to a 1998 GAO study, for example, the Postal Service had instituted 19 outside business ventures since 1991. During the first three quarters in 1998, only four were reported to be profitable. GAO found in their 1998 report that, during the seven year period it reviewed, the Postal Service lost approximately $85 million on such things as coffee mugs, ties, and phone cards. Because the Postal Service has not released current information showing whether these non-core services are actually profitable, this is a contradiction that needs to be explored further, Mr. Chairman. When most businesses lose revenue, providing less service for higher prices and forsaking core services for money-losing side ventures is usually not their response.

I am especially concerned about the impact of closing post offices in smaller communities. It would be unfortunate indeed if the Postal Service's failure to meet today's challenges results in its abandonment of aspects of the core service that made the service indispensable to so many Americans, especially in rural areas. We cannot allow this to occur.

I have no doubt that the Postal Service may need some reforms. The world has changed significantly since 1971. Other nations are also carrying out interesting postal experiments that bear watching. Ours is a large nation, and what works in one country may not work here. Nevertheless, we must be open to the idea that things can be done better than they are today—and aware that we can learn from the experiences of other nations to provide the best postal service for the American people.

I agree with our outgoing Postmaster General when he says that "a seriously weakening postal system would find it more and more difficult to carry the full load of universal service." It is for that reason that this hearing is so important. A weakening postal system must concern us all. In the end, we all want the same thing: the best postal delivery system for all Americans that we can possibly have.

I look forward to the testimony of the witnesses and thank you for calling this important hearing today, Mr. Chairman.

Chairman THOMPSON. Thank you very much. I understand that Senator Akaka has been delayed and wishes to have his statement made a part of the record. Senator Cleland has also submitted a statement for the record.

[The prepared statements of Senators Akaka and Cleland follow:]

PREPARED STATEMENT OF SENATOR DANIEL K. AKAKA

Given the Postal Service's projected $2–$3 billion deficit this year, it is crucial that Congress examine the actions of the Service which affect each and every American. I hope this hearing will assure Hawaii's consumers and businesses that Congress is taking their concerns seriously.

Last week's decision by the Postal Board of Governors to modify the 2000 rate increase has ignited a new round of debate. Some believe raising rates may put the Postal Service in a death spiral. What we do know is that rate increases alone will not fix the serious cash flow and debt problems facing the Postal Service. A good indicator of the seriousness of the situation is that the Postal Service has been reported to be preparing for yet another rate increase filing this summer. I am interested in learning from the Board whether this report is true and learning from management exactly how the Service plans to make up its possible $2–$3 billion projected loss.

The U.S. mail is a basic and fundamental public service. Hawaii's postal patrons and those of other states are entitled to reliable and efficient mail service at a fair

and reasonable cost. With a dedicated workforce of over 800,000 employees, it is the largest federal civilian employer and operates more postal facilities than the number of McDonalds, Wal-Marts, Blockbuster Videos and Starbucks, combined. This infrastructure fuels the private mailing industry that generates $155 billion nationwide annually and employs 6.2 million people.

It is essential that an organization the size of the Postal Service be governed by short and long-term financial goals that support its core mission—providing universal mail service to all Americans at affordable prices.

Because the Service has appropriately sounded the alarm over declining volume and decreasing revenue, I am pleased to have the Comptroller General with us. By placing the Postal Service on the list of high-risk federal programs, Mr. Walker has spotlighted the serious financial and operational problems facing the Service.

The Postal Service has received a lot of attention in the last several months after announcing a freeze on new construction projects, studying the elimination of Saturday mail deliveries, and raising rates. While I support reviewing all options and believe it is prudent, I want to make it clear that before Congress grants the Postal Service greater flexibility, we should understand why the Service is facing a $2–$3 billion projected loss, and what can be done differently.

I wish to invite my colleagues to join the newly formed Congressional Postal Caucus, on which I serve as the vice chairman. Congress should shoulder some of the responsibilities. I am confident that by offering a forum to educate and brief members of Congress on postal matters and concerns, we will be better prepared to work with all stakeholders in finding solutions to our common concerns. I look forward to reviewing the testimony presented at this hearing.

PREPARED STATEMENT OF SENATOR MAX CLELAND

Thank you Mr. Chairman for giving me the opportunity to speak at today's hearing and address the Postmaster General, Mr. William Henderson, the Vice Chairman of the Postal Rate Commission, Mr. George Omas, the Chairman of the Board of Governors, Mr. Robert Rider and the Comptroller General of the United States General Accounting Office, Mr. David Walker. As you know, the United States Postal Service (USPS) was established by the Postal Reorganization Act of 1970. This act chartered the USPS to perform as a business enterprise, with the freedom to provide "non-postal services," ensuring that USPS could provide universal service reliably, efficiently and as inexpensively as possible for years to come. Furthermore, the USPS was mandated to operate on a self-supporting, break-even basis, with particular emphasis on restraining postal rate increases and providing "honest, efficient, and economical management."

The Postal Service is an amazing organization. Its Universal Service program binds the country together by providing inexpensive and reliable First Class mail delivery for every American and every business. The USPS stops at approximately 134 million addresses six days a week and delivers approximately 670 million pieces of mail every day. The Postal Service generates approximately $64 billion in revenue, ranking it 8th in the United States in the Fortune 500 Global listing. In addition, the Postal Service employs approximately 800,000 individuals giving it the nation's second largest payroll, and USPS operates approximately 38,000 postal facilities. Managing any organization this size can be a very difficult challenge, but it was done profitably for much of the latter half of the 1990's.

In 1997 the Postal Service turned a $1.2 billion profit, and had been profitable for the years 1995–1999. But in 2000, the Service showed a net loss of $199 million. The Service originally predicted a deficit for 2001 of approximately $500 million. Early in 2001 that projected loss was revised to between $2 to $3 billion, and with a new rise in rates effective July 1, 2001, the loss is expected to be between $1.6 and $2.4 billion. The Service has gone from profitability to billion dollar losses in less than two years. In order to cut costs and pay its bills the Postal Service has frozen all existing capital construction projects, it is studying the feasibility of eliminating Saturday delivery, the Board of Governors voted to modify the most recent rate decision by raising certain rates, and the Service expects to save $3 to $4 billion by 2005 through its "breakthrough productivity" plan. I applaud several of the efforts of the Postal Service in attempting to meet this challenge, however, I am concerned about the need to promptly eliminate waste and how these cost cutting measures will affect postal consumers.

The Inspector General found approximately $1.4 billion in waste, fraud and mismanagement within the Postal Service. I am aware that eliminating such waste will not alone keep the Postal Service out of debt. However, I would like assurances that USPS is addressing the problems that the Inspector General identified, and I would

like to know specifically what USPS is doing to address these issues. Successful attention to these matters could appreciably increase the credibility of the Service in the eyes of the public and could help USPS meet its financial crisis without decreasing service to postal consumers.

I have heard from many communities across Georgia that they are experiencing service problems at their existing Post Offices. The lines are too long, there is not enough parking or the Post Office is not big enough to handle the volume of mail going through its facility. Georgia has experienced one of the largest growth rates in the country and many existing facilities are being squeezed in their effort to provide prompt, efficient and reliable service. I have been informed by USPS that projects in Buena Vista, Butler, Columbus-Beallwood, Cotton, Darien, Gray, Guyton, Hawkinsville, Kathleen, Lyons, Macon-Downtown, Marble Hill, Marshallville, McCaysville, Monroe, Monticello, Pine Mountain, Pooler, Pulaski, Roberta, Rupert, Sharpsburg and Townsend will be affected by the freeze. I am very concerned about what the freeze in capital construction projects will mean to these growing communities in Georgia and how long it will last. Furthermore, USPS is studying the feasibility of eliminating Saturday delivery in order to cut costs. While eliminating such delivery may decrease transportation and labor costs, the amount of mail will not decrease and mail delivery will either be delayed or carriers will be paid overtime in order to deliver the mail efficiently in five days instead of six. I would like assurances from the Postal Service that efforts will be made to eliminate waste and increase productivity before any services are cut.

Once again, I would like to thank the Chairman and the participants in this hearing for allowing me to speak to you about my concerns. I will review the report for this hearing when it is released and I look forward to working with you in the future on these and other important issues.

Senator CARPER. If we could do that, we would be grateful, sir.

Chairman THOMPSON. Without objection. Senator Carnahan.

OPENING STATEMENT OF SENATOR CARNAHAN

Senator CARNAHAN. Thank you, Mr. Chairman. I would feel remiss if I did not ask you gentlemen which State you would go to, to watch Mark McGwire hit a home run, eat the best barbecue, and enjoy the best country western music?

Chairman THOMPSON. Now, wait a minute. [Laughter.]

We will discuss this later. [Laughter.]

Senator CARNAHAN. Thank you, Mr. Chairman. I would like to thank each of the witnesses for being here today. I can remember, as a young girl growing up, the excitement I felt when the postman would arrive with our mail everyday. He might bring us messages from as far away as New York or Los Angeles. He would deliver a letter to any of my relatives, even those who lived in the rural areas. It is an idea as old as the country itself, a National Postal Service, efficient and convenient—connecting every American to every other American. It is a part of our collective experience, but increasingly this idea is in danger.

At the recent House Government Reform Committee hearing, Mr. Walker, you testified that the Postal Service is at growing risk of not being able to continue providing universal postal service, vital to the national economy, while maintaining reasonable rates and remaining self-supporting through postal revenue. I am deeply troubled by the current estimates of the U.S. Postal Service's financial situation. I am particularly concerned at the prospect that the Postal Service may reach its $15 billion debt ceiling in just 2 years.

I believe that, overall, the Postal Service does an excellent job in delivering the mail. Postal workers in Missouri and all over the country are dedicated and hard-working, but when Americans see postal rates rise twice in 6 months and hear that Saturday service may be eliminated, the Postal Service's reputation is badly under-

mined. Before we eliminate services, we should ask if the Postal Service can be run more efficiently. Before we raise rates, we should think about the impact on our families and businesses. This situation is serious and warrants attention, both by the management of the Postal Service and by Congress, which is why we are here today.

I believe there are three fundamental principles the U.S. Postal Service must abide by. It must provide universal service to the public. It must offer reasonable rates, and it must be self-supporting. If the Postal Service doesn't live up to these three principles, then it's failing its mission and failing the American people.

The first principle is that postal delivery is a public service and must be available to all. People depend on it. From those operating small businesses to seniors living in rural areas, who receive life-sustaining medication through the mail.

The second principles in ensuring reasonable rates. This is important on many levels, from the individual consumer who mails a few items a week, to the large company, whose livelihood depends on shipping its products to its customers. The Postal Service is an integral part of our Nation's economy. Any changes in postal rates, no matter how small, have ripple effects across Missouri and every State in the Nation. While sometimes rate increases are warranted, they should be carefully considered and evaluated with discretion.

The third principle is that the Postal Service must be self-supporting. The Postal Service is a business. There are certain budget realities and constraints that come with that. I sympathize that rising fuel costs make delivery more expensive. This is an issue that businesses and families across the country are struggling with, but fuel costs are not the only factor. We need to look at both the long-term and short-term. I look forward to hearing each of the witnesses' testimony on how costs can be reduced without displacing workers or eliminating services.

There are two points that I would like to leave the panelists today. First, such drastic changes in financial projections in such a short amount of time are unacceptable. Our families have to balance their checkbooks and pay their bills, and they expect the same from our government agencies. This service is too important for the books not to be kept in top order. I am eager to learn what steps the Postal Service can take to prevent this from happening again.

Second, 6-day mail delivery service must be maintained. This service is essential for Missourians, particularly those in rural areas. It is also important for thousands of small businesses struggling to make it on a very small profit margin. That is why I am supporting Senator Harkin's Senate resolution regarding the need to preserve 6-day mail delivery. The resolution opposes the elimination of Saturday home and business delivery. It calls on the Postal Service to take all the necessary steps to assure that these services are not reduced.

Just last week, the Postal Rate Commission approved yet another rate increase. If we cut services while raising rates, we're asking our citizens to pay more for less. We owe them better than that. While I will not be able to stay for the entire hearing, as I have a prior commitment for this same time period. I look forward

to reviewing each of the witnesses' testimony and learning from your expertise.

Thank you, Mr. Chairman.

Chairman THOMPSON. Thank you very much. Mr. Walker.

TESTIMONY OF HON. DAVID M. WALKER,[1] COMPTROLLER GENERAL, U.S. GENERAL ACCOUNTING OFFICE

Mr. WALKER. Thank you, Mr. Chairman. I have a full statement which, with your permission, I would live to have inserted into the record and I will move now to summarize.

Chairman THOMPSON. It will be made a part of the record, without objection.

Mr. WALKER. Thank you, Mr. Chairman. I am pleased to be here today to participate in this joint hearing on the financial outlook and transformational challenges of the U.S. Postal Service. Overall, the Service faces major challenges that collectively call for a structural transformation if it is to remain viable in the 21st Century. A structural transformation of the Service is called for because the Service faces major financial, operational and human capital challenges.

It is a growing risk of not being able to continue providing universal postal service, vital to the national economy, at reasonable rates, while remaining self-supporting from postal revenues, the three criteria that Senator Carnahan articulated. Accordingly, in April 2001, GAO placed the Service's transformational efforts and its long-term outlook on our high-risk list. This inclusion on our high-risk list will focus needed attention on the dilemmas facing the Service before the situation escalates into a crisis where the options for action may be more limited and costly.

The key factors that contributed to our decision to place the Service's transformational efforts and its long-term outlook on our high-risk list included the following: The Service's financial outlook has deteriorated significantly. Its borrowing is increasing, and the Service's debt is approaching the $15 billion statutory limit without having a specified debt reduction plan in place. In addition, the large number of retirements expected over the next several years will place even more pressure on the Service's expenses and its need for cash.

The Service recently deferred capital investments to conserve cash, thus delaying certain needed infrastructure improvements. These deferrals appear likely to continue in the current environment. In March 2001, the Postal Service Board of Governors wrote to the President and the Congress, asking for a comprehensive review of postal laws, and noting that the threat was serious and significant with regard to whether or not the Postal Service would be able to continue to achieve its mission in future years.

Potential losses in First-Class mail volume over the next decade could create large financial deficits, leading to a situation where universal postal service could ultimately be threatened, prices would likely increase at a much faster rate, and other options would need to be explored. The Service is subject to several statutory and other restrictions that serve to limit its transformational

[1] The prepared statement of Mr. Walker appears in the Appendix on page 48.

efforts; the binding arbitration requirement, the rates-setting process and the facility closure restrictions being examples of these restrictions.

The Service has also had periodic conflicts with some of its key stakeholders, including the postal unions and the Postal Rate Commission. We have noted longstanding labor-management relations problems that have hindered improvement efforts, including three labor agreements that cover over half of the Postal Service's workforce, that expired in November 2000, and will now evidently be resolved through binding arbitration. In addition, the Postal Service and the Postal Rate Commission have had long-standing disagreements concerning pricing decisions.

Finally, two key leadership positions need to be filled regarding postal operations and rate setting; namely, a successor to Postmaster General Henderson and a successor to the chair of the Postal Rate Commission. Although the Service has announced some steps to address its growing challenges, it does not have a comprehensive plan to address the numerous financial, operational or human capital challenges that we have noted.

In April 2001, we recommended that the Postal Service provide quarterly reporting on its financial and operating results and projections, in order to enhance transparency and improve accountability in connection with these matters. In addition, we also recommended that the Postal Service develop a transformation plan in conjunction with Congress and other key stakeholders that would address the major challenges facing the Service. Postal Service officials told us that they generally agree with our recommendations, and in that regard I recently met with Deputy Postmaster General Nolan, and we discussed ways in which the Service could move to begin to address our recommendations.

We appreciate the difficulty of this task, given the long-standing nature of the structural problems and major differences in stakeholder views, many of which are outlined in my statement. As I mentioned, we at GAO have already started to reach out to some of the affected stakeholders, to try to obtain an understanding as to their current positions. Some of that is outlined in my statement, and I think you will note that there are some significant differences of opinion in that regard.

But the sense of urgency in connection with the Postal Service is growing. The basic statutory framework that governs the Postal Service has not changed since 1970, despite the fact that there have been significant developments in technology and a much more competitive marketplace that provide alternative forms of communication and delivery choices to both businesses and consumers, and these are likely to continue to escalate in the future.

The Service's ability to provide universal postal service at reasonable rates will be increasingly threatened unless changes are made, both within the constructure of current law, as well as through relooking at the legal and regulatory framework that governs the Service.

I thank you, Mr. Chairman. I would be more than happy to answer any questions at your pleasure.

Chairman THOMPSON. Thank you very much. Mr. Henderson.

TESTIMONY OF HON. WILLIAM J. HENDERSON,[1] POSTMASTER GENERAL, U.S. POSTAL SERVICE

Mr. HENDERSON. Thank you, Mr. Chairman. First, I want to thank the Senate for its cooperation. I have 17 days left after 30 years of public service in the Postal Service, and I have enjoyed it very much. It has been an interesting job, from being postmaster of Memphis, Tennessee for several years, to postmaster of Greensboro, postmaster of Stockton, California, and running plants all across America. It has been very interesting.

Let me say a couple of things, and I will submit my statement for the record. First of all, we agree with the General Accounting Office on their assessment of the Postal Service and of the Postal Service's future. There is no disagreement there, and it is something we have had extensive discussions on. Second, and let me try to put the future of the Postal Service in kind of precise terms. What do you do when your revenues decline and your labor costs are controlled by an independent arbitrator?

If you look at the structure of the expenses, you have 14 Presidentially-appointed individuals. That is the Board of Governors and the Postal Rate Commission, whose primary job it is, is to ensure affordable prices for the American public, 14 Presidential appointees, constructed in 1970 by the Postal Reorganization Act. In effect, when you look back 30 years, and you look at what controls the price of postage—it has been the cost per hour, which has been determined by an independent arbitrator; and that fact is something that needs to be changed.

I am not opposing collective bargaining, and no one in the Postal Service is; but the fact that when we constructed—the United States constructed—the Congress constructed the PRA, one of the most important aspects of that construction was how do you control postage rates? How do you do that? Do you set it up with administrative law judges? How do you do that? The major mandate, the major obligation, of nine Presidentially-appointed Governors and five Presidentially-appointed Postal Rate Commissioners, is to set the rate of postage, and, in effect, causally, that rate is set by an independent arbitrator, and that is something that creates a problem for the Postal Service.

You put that in the context of now what do you do when your revenues—that is, the demand for postage—goes down? You have whatever it be, mergers and acquisitions, Internet as opposed to standard A, competitors as opposed to packages—how do you respond to that? It is very difficult for the Postal Service to respond to a lessening of demand. For example, your letter carrier delivers, on the average, about $1.75 postage to every household in America today. That is to break even. So what happens when you get 20 percent less postage? You do not stop delivering mail. You do not do those sorts of things. You do not go from overnight to 2- or 3-day service. You simply absorb that cost.

What happens when the price of fuel—how long has the price of fuel been going up now? A year-and-a-half? I bought a Dodge Durango 3 years ago, and I filled it up with regular gas at 99 cents a gallon. Today, that is almost $2 a gallon. For every penny in gas-

[1] The prepared statement of Mr. Henderson appears in the Appendix on page 77.

oline, it costs the Postal Service $5 million. It does not have the ability to put a surcharge, like our competitors have, or like the airlines have, or even now, I went into a hotel—I stayed in a hotel the other day; had a surcharge on my room for energy cost. The Postal Service does not have that ability. It accumulates those costs and then dumps them at a point when it changes prices.

Those are antiquated ways of dealing with the future, I would urge you to look at that in the coming days, to look at the statutory construction of the Postal Service, because it is my belief that it is very important to America to have universal service, to have affordable rates, to have an access system. We talk about the digital divide. One of the things that we are doing with Senator Stevens in Alaska is providing access vehicles, small devices in lobbies and certain places, testing them, so that Alaskans who cannot afford to buy computers or cannot afford to buy access modems, can go to their post office and cross that digital divide without having a barrier of $1,500 or $1,000 for an Internet device, and I think that is very important.

So I think the Postal Service is relevant today. It has a strong ubiquity all across America, and it needs to be reexamined in light of its statutory construction. Thank you, Mr. Chairman. I would be happy, at the appropriate time, to answer any questions.

Chairman THOMPSON. Thank you very much. Mr. Rider.

TESTIMONY OF HON. ROBERT F. RIDER,[1] CHAIRMAN, BOARD OF GOVERNORS, U.S. POSTAL SERVICE

Mr. RIDER. Good morning, Mr. Chairman and Members of the Committee. I am Bob Rider. I am Chairman of the Postal Service Board of Governors. I appreciate very much this opportunity to discuss the challenging universal mail service and the necessity for legislative reform. However, before I start, I would like to publicly recognize the 30 years of service given to the U.S. public by our Postmaster General, Bill Henderson.

Bill, as you are all well aware, is retiring on May 31, and we all want to wish you well.

Mr. HENDERSON. Thank you.

Mr. RIDER. The mission entrusted to the Postal Service by Congress is to provide universal mail service to every address in all communities and neighborhoods throughout the United States at affordable prices. This mission of inclusion and facilitation for the Nation's business and personal life is as fresh and relevant today as in the country's beginning. The American people have always enjoyed among the lowest rates and best service in the world. Throughout its history, the Postal Service has grown with the Nation. We still add over 30,000 new addresses each week to the distribution and delivery network, while keeping average price increases below the rate of inflation.

This is the equivalent of a brand new city of Chicago every year. We have had only two rate filings since 1995, both times just a penny on First-Class rate. We have done this by restraining cost and improving productivity, as service networks expand to handle the Nation's growth. In recent months, several forces have com-

[1] The prepared statement of Mr. Rider appears in the Appendix on page 83.

bined to upset the balance between revenue and cost for this year. Postal revenue growth has slowed with a weak economy, accounting for an expected shortfall between $500 million and $1.5 million.

The Postal Rate Commission recommended rates lower than those the Postal Service had proposed and our financial plan had assumed, increasing our net loss by $100 million. Other costs, such as fuel, have grown due to rising prices, adding about $150 million in this fiscal year. Taking these factors in combination, we currently believe the fiscal year 2001 net loss could exceed $2 billion.

The law provides us a limited opportunity to deal with this shortfall. As finances have suffered, the board has attacked the problem with the tools that we have available to us. Earlier this month, the Governors reluctantly decided we must exercise our authority on the record of the most recent rate case, to modify postage rates to adjust a shortfall of about $1 billion, through a rate adjustment averaging 1.6 percent. We took this action to protect the financial integrity of the universal mail system.

Because the adjustment comes so late in the fiscal year, this move yields only about $200 million in a shortfall in the remainder of this fiscal year. In recent years, the Postal Service has had good success with programs for managing work hours and other controllable cost elements. Last year's productivity improvement of 2.5 percent was the best since 1993. In current circumstances, however, extraordinarily and, unfortunately, painful additional measures are essential. First, we have eliminated $1 billion from the capital commitment budget for this fiscal year in order to conserve the cash to pay our bills, and to reduce future commitments to match cash flow.

Next, we have directed management to prepare another rate filing, to get the Postal Service back on a pay-as-you-go footing, maintain financial viability and achieve breakeven, as the law mandates. Also, we have directed management to take a fresh look at all operating expenses, to realize additional savings. A number of these actions are now in place, among these are a hiring freeze at headquarters. Management has eliminated over 1,100 headquarters and headquarters-related positions since the beginning of this fiscal year, along with 20 percent, or 232 of the positions in our area offices.

These reductions are continuing at headquarters, area and district offices. Also, a nationwide freeze in the hiring of processing and distribution clerks. So far, we have over 7,000 fewer career clerks on the rolls than at the end of last fiscal year; also, a series of comprehensive area mail processing studies, which identify opportunities to consolidate operations and to reduce expenses. Many of the delayed capital projects are badly needed. Their postponement will make it difficult to meet the needs of our customers and our employees. The board's responsibilities, nevertheless, require us to make sure that financial resources are on hand to pay bills when they come due.

Every 2 weeks, these bills include one of the Nation's largest payrolls, providing the livelihood of more than 800,000 postal families. In the years ahead, cost-cutting and rate increases within our current statutory framework are not sufficient for the Postal Service to keep pace with today's market dynamics. More businesslike

management is required to maintain the financial integrity of the Postal Service and the foundation for universal mail service. The outdated statutory framework both contributes to current financial problems and severely limits what can be done about them.

The Postal Service has limited authority over its prices, services, wages and other management levers in the postal system. The cumbersome history of the recent rate case, which took almost 2 years to complete, from preparation to finish, spending periods of both economic boom and economic slowdown, illustrates part of our problem. None of the private firms whose services compete with or substitute for the mail go to every household every day. The Postal Service delivers to 136 million addresses 6 days a week. To break even, we need an average of about $1.75 to $2.00 in postage for each delivery point every day. Three-quarters of all households do not receive that much mail each day.

If universal service does not remain economically viable, many Americans will not get the level of service or the affordable prices they are accustomed to receive. The most advanced nations around the world are rapidly modernizing and reorienting their postal systems. The Postal Service delivers 40 percent of the world's mail, but America lags far behind in postal reform. The overseas posts are reorganizing to protect their universal service and keep their rates affordable. Many now come over here to compete for some of our mail. Without vigorous postal reform in the United States, this country faces increasing pressure on the economic foundation for universal service at affordable prices.

The American people should not have to face this result. The United States should continue to have the best, most modern postal structures and services in the world. We pledge that the Postal Service will do all that we can, both to manage the current challenge and to contribute to the success of a comprehensive postal reform measure.

Thank you, Mr. Chairman. I would be pleased to respond to any questions at the appropriate time.

Chairman THOMPSON. Thank you very much. Mr. Omas.

TESTIMONY OF HON. GEORGE A. OMAS,[1] VICE CHAIRMAN, POSTAL RATE COMMISSION

Mr. OMAS. Thank you, Mr. Chairman. My name is George Omas. With me today are my fellow commissioners, Danny Covington, Ruth Goldway,[2] and Trey LeBlanc. As you know, and has already been mentioned, the position of Chairman of the Postal Rate Commission is currently vacant. I was elected vice chairman by my colleagues and have been performing the administrative functions of the chairman since February.

Mr. Chairman, at this point, I would like to request the Committee accept my written testimony that I submitted in advance of this morning.

Chairman THOMPSON. It will be made a part of the record.

Mr. OMAS. I would like to focus my statement this morning on responding to a specific question; the letter inviting me to testify

[1] The prepared statement of Mr. Omas appears in the Appendix on page 88.
[2] The prepared statement of Ms. Goldway appears in the Appendix on page 137.

here today asked whether I concurred with the Postal Service's projection of a $2 billion to $3 billion deficit. The short answer to that is that I cannot evaluate that estimate. The Postal Service has not provided any systematic explanation of its multi-billion dollar projections. The imprecision of its forecasts makes it impossible to evaluate their reliability.

The Postal Service may have detailed analyses that justify these forecasts, but such analysis have not be made available to the public or to the Postal Rate Commission. The Commission's primary function is to respond to the Service's requests for rate and classification decisions. The Postal Service provides detailed supporting cost data when it asks the Commission to recommend rates. However, after the Commission provides its recommendation, the Commission does not have ready access to data that would enable it to know what portion of the Postal Service's rate case cost projections were mis-estimated.

From the limited data available to the Commission, it appears that the major causes of the current losses are costs that are substantially higher than the Service projected just a few months ago. Some of those who think that drastic legislative action is necessary, think that projected deficits may have resulted from a decline in volume caused by growth of electronic communication, but mail volumes are not declining. It also has been suggested that the mix of mail has changed and that the Service is now delivering less-expensive mail. But from the data currently available to the Commission, it appears that the major cause of operating losses are costs that are higher than the Postal Service expected.

The Commission has examined the Postal Service's limited preliminary cost reports for the first half of fiscal year 2001. We have annualized these results for the first six accounting periods of 2001 data and compared those figures with the revised annual projections estimated for fiscal year 2001 at the end of the most recent case. This comparison is quite revealing. Comparing seven important cost elements, the Commission finds that if current cost patterns continue, the Postal Service is likely to incur $1.8 billion more in cost in 2000 than it had estimated to the Commission in July 2000.

My written testimony, on page 14, includes a table that shows the seven cost elements and how inaccurate the Postal Service cost projections may have been. To me, this result undermines many of the arguments suggesting that radical reform of price-setting mechanism is necessary. Mr. Chairman, skyrocketing costs are not the result of volume losses to electronic mail. Skyrocketing costs are not the result of mailers doing more work sharing or switching to less-expensive postal products. Skyrocketing costs, again, are not the result of a failure to rapidly bring new products to the market.

I thank you, Mr. Chairman. I would be pleased to answer any questions.

Chairman THOMPSON. Thank you very much. Well, you have touched on a lot of things that we need to get into today, but I would like to try to lay a little groundwork. Most of our conversation, when we talk to you gentlemen, has to do with rate increases. We demand that you do not increase rates, nor cut any services, and I am sure we will go through all of that.

But what I am interested in, is about our particular State—our neck of the woods—I want to make sure nothing has changed there. We have got to protect ourselves, protect our constituents—but even that is really the tip of the iceberg. I think what today can do is provide us a useful forum for discussing the reasons for these cost increases. It can help us get underneath some of the causes of what is going on with the Postal Service, fundamentally, and what we need to do about it.

It seems to me at the outset that, clearly, Congress is going to have to recognize that we cannot continue to demand the same kind and quality of services that we have always demanded. We cannot make such demands while putting requirements on the Postal Service that drive up costs and mandate losing operations, such as post offices and things of that nature, which are desirable, but just not cost-effective. We have got to revisit these issues.

On the one hand, there are certain things that you have no control over like requirements we put on the Postal Service. On the other hand, there are also certain things that you do have control over. And as far as labor and other groups that are interested—competitors, customers and so forth—we all have our interests. We are all going to have to come to the table and do something different, because it is quite obvious, if you know the GAO and read the reports, and know Mr. Walker, you know that he is not given to hyperbole. I read between the lines. It is obvious that the ox is in the ditch, big-time.

Mr. Walker, just for a minute, let's project out as to what we are dealing with here and what we are looking at. What do we know? Well, first of all, we know that there have been two rate increases already this year. The estimates of where they are have wildly fluctuated, from a surplus at the beginning of last year to estimates of a $2 to $3 billion deficit in February of this year. Now, they are talking about somewhere in the neighborhood of a $2 billion deficit, even after the rate increases, somewhere between $1.6 billion and $2.4 billion for 2001; is that correct, basically?

Mr. WALKER. That's correct, Mr. Chairman.

Chairman THOMPSON. This assumes more optimistic economic forecasts, otherwise the numbers would be worse. It also assumes meeting certain aggressive revenue growth and cost reduction objectives; doesn't it?

Mr. WALKER. It does make certain assumptions.

Chairman THOMPSON. Objectives that have never been met before; have they?

Mr. WALKER. Not consistently.

Chairman THOMPSON. So I think the $2.4 billion possibility is probably low, if you look historically. We have two rate increases. It looks like we are probably going to have another one in July, right, Mr. Henderson? Is that the way it is looking?

Mr. HENDERSON. Actually, it depends on what the economy does, and, as you were talking about, where the losses end up. I think July is probably a bit early, based on current information, but certainly it is looking at another rate increase in the near-term.

Chairman THOMPSON. The near-term would certainly be sometime later this year?

Mr. HENDERSON. That is correct.

Chairman THOMPSON. The speculation has been in the 10 to 15 percent range. Is that reasonable?

Mr. HENDERSON. Based on the existing economy, that is in the range of what it looks like, although we do have a committee that is looking to some alternatives to that type of a rate increase, to try to minimize the impact on the customer. That is being headed up by the Deputy Postmaster General, John Nolan.

Chairman THOMPSON. So, again, getting back to the groundwork. That will be three rate increases in 1 year, a multi-billion-dollar deficit. No real feeling as to what effect that is going to have on business. Some of your postal business, of course, is very cost sensitive, and when your rates go up, your business goes down in some of these areas. Is that not correct?

Mr. HENDERSON. That is correct.

Chairman THOMPSON. So we will have to figure that in, too, which will again exacerbate the problem. As I say, this is based on, to me—these are my words—kind of rosy estimates in terms of revenue growth and cost reduction objectives. So that is where we are. Looking out into the future, Mr. Walker, correct me if my analysis is wrong here. But it is not really an analysis, it is really a rendition of the factors that we are going to have to deal with. One is that in all probability we are going to see a decrease in First-Class mail. First-Class mail is about two-thirds your revenue, is it not, Mr. Henderson?

Mr. HENDERSON. Right.

Chairman THOMPSON. We will probably see a decrease in First-Class mail. Your labor situation is not going to get any better, is it, Mr. Henderson?

Mr. HENDERSON. No.

Chairman THOMPSON. And certainly not in the near-term. The thing that jumped out at me, too, along those lines, Mr. Walker, is the retirement cost that you do not hear a lot of talk about. You say in your report, "The Service has mounting debt and many billions of dollars in liability for future retirement and worker's compensation expenses. These liabilities have increased in part because the Service was statutorily mandated to assume responsibility for funding all cost of living adjustments and health benefits for its retirees since July 1, 1971. For the remainder of this decade, these liabilities will continue to have an increasing impact on the Service's future cash flows, placing the Service under growing financial pressure."

We talk a lot about the fact that many government workers, almost half, are going to be eligible to retire in 5 years. It is certainly true with regard to the Postal Service. You are going to have a high rate of potential retirement in the near-term, and that is going to have a major impact. You are already up to some high numbers, in terms of retirement benefits, which are projected to reach $14 billion in fiscal year 2010. So these retirement payments are going to have a major impact, in addition to everything else that we are talking about. It is going to be an additional load on the back of the Postal Service; is it not, Mr. Walker? What is the significance of that?

Mr. WALKER. There will be a significant cash flow drain associated with being able to make the payments for these retirement

benefits. There is about a $30 billion liability that the Service has right now, I believe, attributable to unfunded past service-related cost for CSRS. The $14 billion, I believe you referred to, Mr. Chairman, is the Service's anticipated future annual retirement cost in fiscal year 2010, which also includes employees that are under FERS and the Federal Thrift Savings Plan, as well.

Mr. HENDERSON. Mr. Chairman, if I could add to that, there is a talent drain, too. The executive ranks of the Postal Service, which account for about the top 1,000 executives, 71 percent of those are over the age of 50. There are only nine executives in the Postal Service under the age of 40—no, seven. I take that back—seven executives under the age of 40. So not only is it a financial trade, you are going to have a huge brain drain here.

Chairman THOMPSON. Mr. Walker has been telling us and trying to explain to us for some time now that this is a government-wide problem. We have reduced our workforce with no strategic plan. We have a requirement for more and more qualified people, highly-qualified people, especially in the technical branches. We have been reducing our workforce with no plan toward what the government needs to do. I am sure that this is true in the Postal Service, as well as everywhere else.

So, again the factors we are going to continue to see are probably rate increases, if we go on the current pattern. That has got to affect the bottom line in these areas that are cost sensitive. Some people are going to quit using the Postal Service because of the price. We are going to see a decline in First-Class mail continue. You are going to see continuing labor problems. Your labor situation is built-in, and the retirement part of all of that is going to be increasingly onerous. Your productivity, while you are trying, has been a real failure of the Postal Service. I mean, it does not look like to me like you are going to increase our productivity enough to make any measurable difference.

While you have increased productivity 11 percent since 1970, your productivity has actually declined in 5 of the last 7 years. This occurred even though the Postal Service has spent billions of dollars in automation and technology trying to improve productivity. With regard to the Postal Service's efforts to have other businesses to generate alternative streams of income, such as e-commerce and things of that nature, you budgeted $230 million. You wound up making $2 million for fiscal year 2001. There does not seem to be any Lone Ranger coming over the horizon to save that day, in terms of making money in these new ventures.

There is no plan, as I understand, Mr. Walker, with regard to these financial problems that the Postal Service has. Either with regard to the finances, or the costs, or the projections, or the human capital part of the equation, there is no plan, is that correct?

Mr. WALKER. There is not a comprehensive, integrated plan that would include transformational proposals, as well. No, there is not.

Chairman THOMPSON. We are losing our Postmaster General and we are losing the Chairman of the Rate Commission. Other than that, everything is all right. [Laughter.]

So the idea that we can spend all of our time on these details and not recognize that we have got serious underlying problems is really keeping our head in the sand.

Mr. Walker.

Mr. WALKER. If I may, Mr. Chairman, I think the bottom line is the status quo is not sustainable. We must recognize that there are a variety of structural problems that need to be addressed. The answer is not merely to increase rates or merely pursue incrementalism, to do a little bit more here, a little bit more there. We need to engage in a fundamental reexamination and transformation debate in connection with the Postal Service. Quite frankly, we need to be able to put on the table things that historically have not been put on the table. For example, what is the definition of universal postal service? Right now, the definition might be 6 days a week everywhere.

Clearly, whatever that definition is has to be met in rural Maine, rural Alaska, and other remote areas, irrespective of the cost. That is essential, because it is part of the fundamental definition. But what is the appropriate definition of universal postal service, given changes in technology, given alternative forms of communication that exist today?

Chairman THOMPSON. And what are we willing to pay for it?

Mr. WALKER. And what are we willing to pay for it, and should one size fit all? For example, in many areas such as health care, you have a basic guarantee and you have options. If you want more than the basic, you can get it, but the question is at what price? So what we need to do is rather than looking back—yes, we need to learn from the past—but the status quo is unsustainable. We need to basically engage in a fundamental examination and we need to look forward, in light of not just today, but the changes that we know are coming tomorrow, some of which you mentioned; the fact that more and more bills are being transmitted and paid electronically. Other countries have already seen this.

A lot of that involves First-Class postage, the 34-cent postage, the transmittal of payments. First-Class postage covers about 70 percent of the Postal Service's overhead costs. So there are fundamental issues here that we have got to deal with, and we are not going to be able to deal with then through incrementalism. We are going to have to put some proposals on the table, with pros and cons, that you have to look at as a package, because if we look at each element by itself, it can easily be torn down; but then again, we have to keep in mind, the status quo is unsustainable.

It is like Social Security and Medicare; the status quo is unsustainable. Ultimately, we have to do something.

Chairman THOMPSON. You have touched on something very important about government, and that is the fact that there are some areas where that is true, and the status quo is unsustainable. The question is not whether or not it is unsustainable, because it clearly is. The question is whether or not it has to get a lot worse before it gets any better. Whether or not the whole thing has to collapse and we have got to have a massive infusion of appropriated funds up here overnight someday. It is going to be a surprise to everyone. Or whether or not we can go about doing something before then.

We are going to be here for awhile, but I do not want to take all the time this morning. So I am going to wait till my next turn for some other questions.

Senator Carper.

Senator CARPER. Thank you, Mr. Chairman. Hockey great Wayne Gretzky was once asked, "Why are you such a good hockey player," and he replied, as some of you have heard, "I go where the puck will be, not where the puck is."

We have talked today about what your business was like 30 years ago, Mr. Henderson, when you joined up, and 20 years ago, 10 years ago, today, the environment in which you compete. Let's talk about what it is going to be like a few years down the line. I turned to the Chairman during, I think, Mr. Rider's comments, and I said, "You know, it would be interesting if we had a futurist here, who actually thought about these kinds of issues and could look down the road and take us with him or her."

Let me just ask each of you to put on your futurists hats for a minute, a minute apiece, and we will start over here with Mr. Omas. But I am just going to ask you, put on your hat as a futurist. Where are we going to be 10 years from now? What is the environment that the Postal Service is going to be competing in 10 years from now?

Mr. OMAS. Well, I think that one of the places the Postal Service should look is at its core business, that is, of delivering mail. Many of the new markets, whether it be in electronic mail or whatever, have not really—as we all know—turned any revenue for them. In fact, it has cost the Postal Service a great deal of money. As one GAO report said a couple of years ago, I think they lost over $88 million on several endeavors like T-shirts. I think that in the future the Postal Service should look at—it has a tremendous ability to deliver—they have the household—they have the structure, and I think they should look at that core business and expand on developing other products or whatever to be delivered by the Postal Service.

Senator CARPER. Thank you. Mr. Rider, what will be the competitive environment 10 years from now for the Postal Service?

Mr. RIDER. Well, looking back, Senator, we have not done such a bad job. In 1971, when the Postal Reorganization Act was passed, postage was 8 cents. It has gone up 325 percent since then, but the CPI has gone up 343 percent. In the last 10 years, postage went up 36 percent and the CPI went up 37 percent. In the last 5 years, postage went up 6 percent——

Senator CARPER. Excuse me. This is all well and good. I appreciate your setting the record straight. These are important things to get straight, but that is not what I am asking. What I am asking is where are we going to be 10 years from now? What will the competitive environment be like 10 years from now?

Mr. RIDER. We are mandated to give universal service, and I think it is very important, as the Senator from Alaska has stated. We need to give universal service, but we have got to have the tools to work with, in order to provide that, and those tools have to come through reform.

Senator CARPER. You have answered two questions, neither of which I have asked. [Laughter.]

And those are good answers, but unfortunately not the question I am asking. Just think about it for a minute.

Mr. RIDER. What is it in the future?

Senator CARPER. Ten years from now, what do you think it is going to be like out here—to compete with? Are we going to have more E-mail, more fax machines?

Mr. RIDER. You will be ordering stuff over the Internet just like that, but you cannot deliver it over the Internet. It is going to have to come from point A to point B to get to your house. That is where we should come in.

Senator CARPER. Mr. Henderson, 10 years from now, you will have your feet up somewhere.

Mr. HENDERSON. That is right. I will be looking at a partially-privatized Postal Service. I think that the Congress, over the next decade, will privatize the Postal Service and make it an independent organization. I think a monopoly will be gradually reduced and open to competition. The reason I say that is not because of any insight into the U.S. Postal Service, but insight into the Postal Service's world. If you look at the Deutsche Post, which has testified before Congress, they are on the open market. I think that is going to happen, and I think there is a lot of resistance to it today. It is kind of like speaking about the devil, but eventually that is going to happen and this Congress is going to do that.

Senator CARPER. Thank you. Mr. Walker.

Mr. WALKER. I think evolving technologies will continue to have an adverse effect on the traditional services provided by the Postal Service. I think competition will increase, and I think because of that, the Postal Service needs to step back and say what is core? What are the core products and services that need to be provided? What is universal service? To what extent should non-core services be provided, and, if they are going to be provided, based upon what market analysis? What competitive advantage does the Postal Service have to be able to do that, verses private sector entities?

In many cases, I think there will be more public-private partnerships. I think, as Postmaster General Henderson mentioned, whether or not the Postal Service will ever be privatized or partially privatized is obviously a major issue, and I am not going to comment on whether it should be or not. That is not my job. But I will tell you we have to look overseas and find out what other countries are doing. We are a much larger country. We are much more geographically dispersed, and we have different wants and needs than other countries do, but we can learn from what some other countries have done in this area.

Chairman THOMPSON. Excuse me, but their postal services are now over here, competing with us in some instances, isn't that correct?

Mr. WALKER. That is right, for international bulk mail, and presumably they could try to expand that, to compete in other areas where they could skim.

Senator CARPER. If you would turn to your employees, the folks who are out there sorting mail today, the people that are out there delivering mail today, and say to them, "Help us solve this dilemma," any kind of idea what kind of recommendations they

would make, the people actually close to it, do it every day? What kind of recommendations would they make?

Mr. HENDERSON. I think they would say put pay-for-performance in, which is an issue; incentivize both revenue and cost-reduction efforts.

Senator CARPER. Have you had the opportunity to experiment with that at all?

Mr. HENDERSON. We have in management, but not with the unions. We are pursuing that right now with the unions, in collective bargaining.

Senator CARPER. Is there any interest on the other side, on the labor side?

Mr. HENDERSON. There is a discussion. I would not call it an interest. There is a discussion. I would say that they would say have more self-management, cut back supervision because everybody is an adult. They would say take out the monotonous tasks, capitalize it—when I say capitalize it, I mean automate it, the monotonous tasks, because people really want to—they want to be involved in their work. They want to contribute. The average postal worker is a very dedicated, educated individual. So they want to contribute. It is the system where they do not contribute.

It is the fact that you stack mail on a sorter, and that is what you do. That is a job we ought to eliminate. They would say reengineer some of that work. It is much like the automobile industry where you are putting a lug on a wheel. You want to eliminate that job, because that is not something that a human being wants to do all day long. They would give you that kind of feedback. But they are very dedicated to service.

My father was a railway mail clerk for 38 years, and service was just—if you missed a pouch at a post office on a train, he would go nuts. They would try to stop the train, and I think you have that attitude, especially amongst letter carriers and rural carriers in America. That is why you have mail service at the high levels that it is today, measured by Price Waterhouse. It is because of a lot of dedication.

Senator CARPER. Let me ask, and I am not sure who to direct this question to, and this will be my last one, Mr. Chairman, and then I will pass it on. In terms of initiatives that have been launched by the Postal Service in the last several years, where you have attempted to be more entrepreneurial, can you cite for me some examples where you think you have been pretty successful, maybe an example or two where you think you could be if we would allow you to be?

Mr. HENDERSON. I think the area where we could be, if you would allow us to be entrepreneurial, is in negotiated rates with customers who provide efficiencies in mail preparation that we could pass on. Right now, it is essentially one-rate-fits-all, and, I mean, you have all been in business at some level or another. You know that if you do not control your pricing or do not have the ability to control your pricing on a near-term basis, you are very limited in what you can deal with, and I think that is a fundamental problem with the Postal Service.

The other thing in being entrepreneurial is speed-to-market is very important. I have been in business prior to the Postal Service.

If you do not have speed-to-market, you are not going to be entrepreneurial, and we have no ability to really have speed-to-market. We have to go through a public hearing, and if we are going to sell a very entrepreneurial service and you have to have a public hearing, somebody is going to beat you to the market. So the limit of pricing and speed-to-market are two inhibitors that are just obvious to anybody who has run a business.

Senator CARPER. Mr. Rider.

Mr. RIDER. I was just going to say that freedom in pricing does not necessarily mean the freedom to raise rates. It means the freedom to reduce them during periods of low-volume. We have periods during the year when our volume is just normally low. We have periods when the volume is high. If we had the freedom of pricing flexibility, we could encourage people to mail during that off-season and raise the rates during the heavy season, to help even out that mail flow.

Senator CARPER. Mr. Omas.

Mr. OMAS. Senator Carper, I think that the statute, Title 39, as it now stands, allows for flexibility. There is nothing in the law that says that they cannot innovate. Because it is a monopoly, before the Service can negotiate a contract, it should be brought out in the public so that competitors—to see what effect it will have on the stakeholders that do the mailing. As far as—we have done a number of expedited cases in the last couple of years that, in essence, are a form of negotiated service contracts. We did the ride-along and things like this that specifically hit a market.

So there is flexibility now, except that the law requires that it be brought to the public's attention before these services are negotiated.

Senator CARPER. Thank you. Mr. Walker, the last word?

Mr. WALKER. One of the problems, Senator Carper, is if you look at the cost structure of the Postal Service, a very high percentage of their costs are fixed costs, rather than variable costs, which means that they have very little ability to be able to adapt quickly to changes in revenue streams, and that is one of the things that is going to have to be looked at. They have a significant fixed cost structure, and it goes beyond just the issue of infrastructure, which, quite frankly, is not just a Postal Service issue. It is a government-wide issue, in light of technological changes that have occurred over the years, but it is also in the area of labor cost, as well.

I know, for example—at least it is my understanding—correct, me if I am wrong, Mr. Henderson, that they have, for example, a policy whereby when people are hired in, they are on probation for 2 years. So theoretically they can do something with regard to headcount with regard to those individuals, but for people that have more than 2 years, they have very limited flexibility. The problem is the last thing in the world you want to do, in light of the retirement eligibility rates that the Postmaster General mentioned earlier, is to say if you have just been here for 2 years, you are going to be the first one to go. That compounds your problem, and so one of the things that has to be looked at are some of these structural issues and how they can gain more flexibility over some of these.

Senator CARPER. Well, Mr. Chairman, I find this whole issue just fascinating. I do not know who on this Committee is interested in leading the charge, if it is you or Mr. Cochran over there or others, but I want to sign up to be a part of the solution and to work with folks here at the table, the people who will be taking your seats, and those who represent the employees of the Postal Service. This is an important issue and it is one that I look forward to joining you.

Chairman THOMPSON. Thank you very much. I now call on the Subcommittee on International Security, Proliferation and Federal Service's Chairman, Senator Cochran.

Senator COCHRAN. That is quite a title. It is hard to live up to all that.

Mr. Rider, you mentioned the time it took to respond to the last rate increase request. It seemed like a long period of time to me. One question that I have is whether or not we should impose a statutory limitation of time within which a request for a rate increase must either be denied or approved.

Mr. RIDER. Well, that would certainly help, but with the regulations as they are today, it takes us 6 months or more to prepare for a rate case. With the Postal Rate Commission, it usually takes them——

Mr. OMAS. The statutes allow 10 months.

Mr. RIDER. Ten months.

Senator COCHRAN. So there is a limitation.

Mr. OMAS. There is a limitation.

Senator COCHRAN. Should it be shorter? Is that justified? Why does it take so long?

Mr. OMAS. The problem is that when the Postal Service submits their rate recommendation or a rate case, it is the first time that we have ever seen the figures, and by the time those figures are published and you get them out to the stakeholders and those who are in the mailing community have a stake in what the rates will be, they must then present a case, and then that takes about 3 months, and then the Postal Service rebuts their case. So the thing we get from the stakeholders and the community all the time is there is not enough time.

Actually, at the end of the 3 months for the stakeholders and approximately 3 months for the Postal Service to review the case, we at the Commission have about 6 weeks actually to put together and to analyze the public record to make our decision.

Senator COCHRAN. Let me ask a question on another subject. We have had an interest in the new businesses that the Postal Service has gotten into, and Mr. Henderson and Mr. Walker will realize that we have had a couple of hearings. We have had two GAO reports on this subject, specifically dealing with the e-commerce activity of the Postal Service. One question that I have is how much revenue is the Service counting on from its new products and services, such as e-commerce? Is the Service on track to achieve this target? I should ask Mr. Henderson.

Mr. HENDERSON. It is minuscule. The Postal Service is a $65 billion organization. It is not going to reinvent itself into another $65 billion organization. If you look at what the Internet does—I will tell you in a nutshell what the strategy is. The biggest strategy the

Postal Service has for the Internet, and it is what large businesses across America are doing, is using the Internet to take friction out of itself. In other words, take personnel. Do it on a Web site instead of going to a personnel system. Take purchasing, do it electronically instead of talking to a purchasing agent. It has nothing to do with selling a business. It has everything to do with cost-cutting.

The second thing that the Postal Service is doing with the Internet is creating an information platform that allows customers to watch their mail, and that adds value. Whether or not we charge for that insight or not is yet to be determined. It develops an activity-based accounting system, and it allows managers to have better information about things that are going on in the Postal Service so they can make better decisions. Those are the two biggest initiatives of the new technology age, and it is not really about selling services. There has been a lot of hype. We have experimented with some of that.

We have eBill Pay, for example, the largest electronic bill payment site. The major use of that is to see what the trends are, because we have $17 billion of our $65 billion in bill payments and presentment. We think that is going to go away. The GAO has talked about that, about the potential for that, and we learn from that site. We learn about consumer habits and what drives them in one direction or the other, and it has been misconstrued in the media. We are not trying to reinvent ourselves into some e-commerce organization. We use e-commerce constructively, but we are, at our core business, a mail delivery system, and that is what we will be in the future.

Senator COCHRAN. The GAO report indicated some actions that could be taken by the Postal Service to eliminate some inconsistencies with its estimates of cost and revenues with respect to e-commerce activity. Has there been any action taken by the Postal Service to respond to those suggestions?

Mr. HENDERSON. We agreed with all those suggestions. Actually, we worked very closely with GAO. They were very helpful in looking at our fledgling e-commerce business. We made some mistakes in the beginning, when we launched it, and they were very helpful in suggesting procedures to be put in place, and we have implemented those procedures, and I am almost positive that Mr. Walker will have a follow-up review of the Postal Service in those areas, and we are prepared for that.

Senator COCHRAN. Is there ever any decision made to abandon a service or a product if it fails to meet its revenue?

Mr. HENDERSON. Yes, under the e-commerce areas, we will—the Board of Governors has put very strict mandates on us to have a lifecycle of the products. We have a learning curve, and then we make some decisions on whether or not to stay in it or get out of it. So, yes, there are some strict guidelines on management.

Senator COCHRAN. Are these decisions made by the Board of Governors or made by you? Who makes those decisions?

Mr. HENDERSON. Well, they are made by management in most instances, as a result of the board requiring certain restrictions on us. We agree to stay in a business so long or get out of it. If it does not have a net income opportunity or it does not have a learning

situation, in which we are learning a lot about our core business, then we are going to get out of that sort of thing.

Senator COCHRAN. Have any products of this kind, or services, been canceled?

Mr. HENDERSON. Yes, in fact, I will provide a list of all the products and services we have, and those that have been canceled and those that have positive net incomes.

Senator COCHRAN. That would be good to have for the record. Thank you very much.[1]

One other sort of macro question: Both Mr. Walker and Mr. Henderson talked about the statutory framework, and the fact that there has not been change to this framework since the Postal Service was created in 1970. What changes should be made, based on your knowledge of what is happening and the evolution of technology, demand, and cost? Mr. Walker, do you have in your reports to the Committee any specific suggestions for statutory framework changes?

Mr. WALKER. We have not gotten to the point, Senator, where we outlined specific recommendations. Frankly, we have recommended, however, a process that needs to be followed in order to come up with that. My view is, if you look at the statutory framework, there are several problems. One problem is it is cost-based. It is cost-based from the standpoint of determining what revenues are. One key question is how do you define cost? Second, if it is cost-based, how do you define labor cost. Obviously, I am a strong believer in collective bargaining, as I am sure you and others are.

Basically, what has happened over time is it has been cost-based, without enough market-based principles. There is binding arbitration, which I understand might have been done as a trade-off back in 1970, in order to avoid the possibility of a strike. Obviously, needless to say, Postal Service workers are dedicated professionals and they are essential to our economy. There is no question about it.

But there are other important elements, as well. There are issues with regard to inability to close facilities in some circumstances, even in urban areas where there can be clear and compelling cases they are not needed, and therefore they do not really affect the ability to reach remote areas and to meet any reasonable definition of universal service, even under the current definition of universal service.

So I think there are a number of things; and candidly, Senator, I think what has to happen is there has to be a set of proposals come up, a package that comes up to the Congress, that deals with these major problems, with various pros and cons, so that you can engage in a debate about what needs to be done, and to look at it as a package, rather than individual elements, and as compared to the status quo, because everything is relative, and I think that is what we think has to happen here.

Senator COCHRAN. One other statement that you made to the Committee in your prepared statement was the need for a comprehensive plan. I think that was your phrase. Is this the same

[1] Responses from Postmaster General Henderson appears in the Appendix on page 108.

thing as a strategic plan? Somebody else mentioned a strategic plan. Is that the same thing?

Mr. WALKER. I think it is more than that, Mr. Chairman. The issue is that clearly there is a lot of opportunity to help make progress in the existing law by focusing on people, process, and technology, to reduce cost and increase productivity. There is clearly opportunity to do that, but that is only going to delay the day of reckoning before the Postal Service has to deal with the underlying structural problems. Clearly, you need a strategic plan as to where you are going and how you are going to get there, but I think the transformational plan also embodies, not just actions that could be taken within the context of current law, but also possibly what type of legislative changes might be necessary.

A strategic plan typically is what enterprises are going to do within the context of current law, and we need to come up with specific options, pros and cons, with regard to how do you deal with some of the underlying structural problems associated with the Service. I think, frankly, the board has a major responsibility for leadership in that regard. I mean, they need to be involved in strategic planning. They need to be involved in succession planning, and I think they need to help facilitate this public dialogue and debate, because we are on a path that is not a positive path.

Senator COCHRAN. Is the GAO capable or are you qualified as an agency to help develop this comprehensive plan?

Mr. WALKER. Well, candidly, I believe, Mr. Chairman, it would be better if the plan was developed by management or in consultation with stakeholders or by an independent business-oriented authority. We would be happy to review that and comment on it, but I do not know that it is appropriate for the GAO to come up with, "the plan." We can clearly contribute to it. My personal view is that it should not be a single plan. It should be various options, and there may be more than one alternative that could be looked at, with various pros and cons that then could be discussed and debated.

I think the idea that you are going to come up with one plan that you are going to get a consensus on just does not exist. So, in the end, we are going to end up having to come up with what is the best of available options.

Senator COCHRAN. What is your reaction to that, Mr. Henderson?

Mr. HENDERSON. I agree with it.

Senator COCHRAN. How about you, Mr. Rider?

Mr. RIDER. I agree with it, and we are working on it.

Senator COCHRAN. You are working on a comprehensive plan?

Mr. HENDERSON. Yes.

Senator COCHRAN. When can we expect to hear about it, and what the details may be, and will it require congressional action to implement?

Mr. HENDERSON. Yes. In fact, we can provide you with a copy of our initial efforts. We will provide that for the record. It is signed by the chairman.

Senator COCHRAN. So it has been completed? You have completed a comprehensive plan and you are ready to submit it to the Congress; is that it?

Mr. HENDERSON. Preliminary efforts on statutory reform.

Senator COCHRAN. I see.

Mr. RIDER. That is one part.

Senator COCHRAN. Who is doing the other part?

Mr. RIDER. We are working on the other part, too.

Senator COCHRAN. This is beginning to sound George Orwellian here, Kafkaesque.

Mr. RIDER. The legislative reform package we have done, it will——

Senator COCHRAN. All right. We will talk about it some more. I am using up too much time.

Mr. Chairman, thank you.

Chairman THOMPSON. Thank you very much. Senator Collins.

Senator COLLINS. Thank you, Mr. Chairman.

Mr. Henderson, I want to talk with you about an area of avoidable cost. Before I do so, I do want to thank you for your many years of service to the Postal Service and your country, and before I launch into this issue, which concerns me greatly, I want to make clear that I do not think, in any way, that you condone the issue I am about to discuss. As you may know, the Postal Service in southern Maine has been sued at least five times since 1998 for sexual harassment of female employees, producing jury awards and settlements that have exceeded $2.6 million.

Those are just the settlements that we know about. In three of the cases, the settlement amounts were not disclosed publicly. So, undoubtedly, the cost is even higher. Obviously, the vast majority of postal employees in Maine and elsewhere do not participate in sexual harassment. They do not condone or tolerate it in any way. But clearly there is a serious pattern and problem when you have five cases in that short of a time, that produce awards totaling more than $2.6 million. That is an area of avoidable cost.

It also, obviously, more fundamentally concerns me because it harms the employees of the Postal Service, who have been subjected to absolutely unacceptable sexual harassment. What is the Postal Service doing to prevent these kind of cases in the future, which obviously have an adverse impact on morale, are unfair to the employees, and cost the Postal Service real money to settle?

Mr. HENDERSON. Well, first of all, let me say we have a zero tolerance for sexual harassment. I have actually fired four or five people in my career for sexual harassment. I was an investigator 25 years ago in those instances. These cases crop up, and they are terrible, and we do not like this, but when you have 800,000-plus employees, you have these situations exist. It takes an incredible amount of communications and training to tell people, to show people, what the work place should be and what the standard is, and we constantly have this.

I actually go through the training myself. We have a requirement that all of our managers go through sexual harassment training. In the case of Maine, we have had to put special teams in there, sensitivity teams. We are in the process of reviewing whether or not disciplinary action should be taken against individuals. It is a day-in and day-out issue in any large organization in America, and we are very vigilant about it. We are very apologetic when it occurs, and where we find culprits, we take very swift and decisive action with regard to that.

Senator COLLINS. What concerns me is there appears to be a disturbing pattern here when you have five essential successful cases—five cases settled for millions of dollars in a period of 3 years. That is just not acceptable.

Mr. HENDERSON. No, I agree with that. I absolutely agree with that.

Senator COLLINS. Do you know how much the Postal Service is spending nationwide to settle sexual harassment cases?

Mr. HENDERSON. Yes, we track all of those settlements. I will be happy to provide that for the record. I do not happen to know off the top of my head what it is, but we do track all of our settlements, both in-court and out-of-court settlements, with regard to complainants.[1]

Senator COLLINS. Obviously, as an employer, the Postal Service would not want to, in any way, tolerate sexual harassment, but there is a monetary implication here when you are paying out millions of dollars to settle cases that never should have occurred in the first place. So this is something that I think deserves more attention by senior managers at the Postal Service, because no employees should be subjected to sexual harassment. Also, at a time when you are facing such financial constraints, you should not have to be paying out this kind of money every year to settle cases that should never be occurring in any work environment.

Mr. HENDERSON. I actually agree with that. I think there is a greater moral principle than there is a financial principle.

Senator COLLINS. I agree. I wanted to link it to the purpose of this hearing, but it is of great concern to me.

Mr. Rider, it is my understanding, and I think you referred to this, that the Postal Service in March wrote to the President and the Congress, asking for a comprehensive review of postal laws. The letter that you sent was provided to me first by the President of L.L. Bean, probably Maine's best-known company and a company whose future depends on an efficient Postal Service. The President of L.L. Bean wrote to me and not only provided me with the letter that the Board of Governors had sent to the President, but also suggested that perhaps it would be helpful to have some sort of Presidential Commission created to look at the operation of the Postal Service and provide specific recommendations. Could you give me your reaction to that recommendation by L.L. Bean?

Mr. RIDER. Yes, we would certainly agree to that—any way that we can get the job done. The danger in doing that would be the time that it would take to organize a Commission and bring them up to speed and get it done. We have sent a reform package, as I mentioned earlier, to the House, and that will be provided to you right away, and that is what we had in the way of reform. We are also working on our strategic planning committee, to get a strategic plan to go along with the reform.

Senator COLLINS. But do you think that an independent look by an outside Presidential Commission would be helpful?

Mr. RIDER. That would be fine.

Senator COLLINS. Thank you.

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[1] Responses from Postmaster General Henderson appears in the Appendix on page 108.

Mr. Walker, I want to follow up on the issue that the Chairman raised about productivity in the Postal Service. GAO has testified that, at a time when we have seen unprecedented technological advancement and really an explosion in private-sector productivity that has helped keep inflation down and prices down, that the Postal Service has increased its productivity by only 11 percent over the past 3 decades; and, indeed, the Chairman noted that during one period—I think it was between 1993 through 1999—that productivity actually declined in the Postal Service, which is contrary to the experience of many large private organizations.

It is my understanding that the GAO is studying whether or not the Postal Service's breakthrough productivity plan will produce the kinds of cost savings, which I think are in the neighborhood of $3 to $4 billion over the next 5 years, that the Postal Service is projecting. Do you have any preliminary findings or any assessment of whether that plan is a realistic one that could help break this disturbing trend?

Mr. WALKER. We do not have the preliminary findings yet, Senator Collins. I will tell you, as you pointed out, that while the Postal Service has had a near record year this past year in productivity increases, about 2.5 percent, it has been a roller coaster. Since 1970—it is only an 11 percent increase since 1970. There are a variety of reasons for that. In some cases, as we pointed out in prior reports, we have noticed that there has not been enough focus on the design of this technology and the implementation of these technologies in a universal manner throughout the Postal Service.

There are other issues that we have raised, as well, including the incentives associated with it, down to the level of people who are actually doing the work. We will be looking at this area, and I will be happy to provide back to you and the Committee our findings, but it is too early to have preliminary conclusions yet.

Senator COLLINS. Thank you. I look forward to receiving those results. Thank you, Mr. Chairman.

Chairman THOMPSON. Thank you very much. Gentlemen, primarily Mr. Henderson, Mr. Rider, and Mr. Omas, I want to talk a bit about your rate case procedure and the facts leading to these last, most recent rate increases. I want to discuss how they came about, because there is clearly a disagreement or difference of views between the Postal Service and the Rate Commission on this. I think most people would probably be surprised to know exactly how it works. That is, that the Postal Service goes before the Rate Commission and presents a requested rate increase. Then, if the Postal Service does not get what it wants, it can come back to them again. If it still does not get what it wants, it can come back to the Rate Commission a third time. Finally, if it still does not get what it wants, the Postal Service, by unanimous vote, can do what it wants to do anyway, right?

Mr. HENDERSON. That is right.

Chairman THOMPSON. So that is one thing that might bear a little discussion—whether or not that is what happened here in this particular case. Within that framework, what happened in this latest instance was that, in January of last year, you filed your case with the Commission. You asked for a 6 percent increase, including a $1.7 million contingency amount; is that correct?

Mr. HENDERSON. That is right.

Chairman THOMPSON. At that time, you were projecting a surplus of $500 million for fiscal year 2001. As has been pointed out, the Commission has 10 months to consider this. I can only imagine how laborious this process is. I have read a little bit about it. There have got to be huge law firms doing nothing in this town except handling rate cases. It reminds me of the old transportation cases, back when that was regulated. As I understand, there are over 70 parties to the procedure—everybody has got a dog in the fight. Everybody has witnesses. Two-ton trucks pull up with documents. I mean, literately, right? You go through that for 10 months. So you went through that, and in November, you, Mr. Omas, and the Commission, decided against a 6 percent increases. You decided instead on a 4.6 percent increase, and instead of a $1.7 billion contingency amount, you decided on a $700 million contingency amount. Is that correct?

Mr. OMAS. That is correct, $1 billion contingency is what we actually gave them. They asked for $1.7 billion and——

Chairman THOMPSON. You cut it by $700 billion.

Mr. OMAS. Yes, sir.

Chairman THOMPSON. That is right. The Governors agreed to allow the recommended rates to be implemented, but to do so under protest. So, they implemented the new rates and then the Postal Service came back to the Commission and requested that the full revenue request be restored. Is that correct?

Mr. OMAS. That is correct.

Chairman THOMPSON. Here is where we have an issue, at least one or two. As I understand it, your position is, the Postal Service did not give you any material that would indicate to you the need for what it was asking for.

Mr. OMAS. That is correct.

Chairman THOMPSON. At the time you first turned the Postal Service down, it is your position that the evidence before you did not justify that kind of increase.

Mr. OMAS. That is correct.

Chairman THOMPSON. You turned them down, then they came back to you again and did not supplement the record with additional information; is that correct?

Mr. OMAS. That is correct.

Chairman THOMPSON. To justify the increase——

Mr. OMAS. And we had offered them the opportunity to reopen the case, and they declined to reopen the case.

Chairman THOMPSON. Let's stop right there before we continue on our little chronology. Let's ask Mr. Henderson and/or Mr. Rider to comment up to this point, as to whether or not that is true.

Mr. HENDERSON. Well, we obviously do not agree or we would not be in the controversy right here. I will give this to you, for the record, as the testimony on what the current situation was in the Postal Service.

Chairman THOMPSON. Let me ask you some specific questions. Then you can comment however you want to, but break it down a little bit. Do you disagree that you were projecting at that point, in January 2000, a $500 million dollar surplus?

Mr. HENDERSON. No—you are correct.

Chairman THOMPSON. And you supplied information to the Commission, and with those projections, they turned you down. When you came back to them again, did you supplement the record or did you open up the proceedings, as was your right? Did you supplement the record with any additional figures or numbers or projections?

Mr. HENDERSON. We did not reopen the record, but we gave sufficient testimony, in our opinion, to have an accurate view of what the economy was doing at the time. I will say that in the year 2000 we began to see shortfalls in revenues, which we reported to the Commission, of about $240 million. We then were forced—we reduced, using good business judgment, our revenue forecast in 2001 by $630 million, and then we were hit with fuel inflation on the order of magnitude of—in the case of $300 million, and we had an unexpected cost of living adjustment, because fuel drives our COLA cost, of about $430 million.

Chairman THOMPSON. As I recall, your transportation costs constitute about 10 percent of your costs, is that correct?

Mr. HENDERSON. That is right.

Chairman THOMPSON. And fuel is a part of that?

Mr. HENDERSON. Every penny, as I testified earlier, costs the Postal Service $5 million, every penny of gasoline.

Chairman THOMPSON. So what percentage of your overall costs does fuel constitute? We know it is less than 10 percent.

Mr. HENDERSON. It is a major driver in our transportation costs, and transportation, as you said, runs about 10 percent of our costs.

Chairman THOMPSON. Do we know how much of that 10 percent is fuel?

Mr. HENDERSON. Yes, I can provide that for the record. I do not know it off the top of my head.[1]

Chairman THOMPSON. You understand that you are mentioning some facts here that would indicate that some circumstances were in the process of changing. Mr. Omas' position, as I understand it, is that you did not lay out sufficient facts to him at that time to justify a reconsideration. Is that what you are saying?

Mr. OMAS. Mr. Chairman, in July 2000, just prior to the last of the hearings of the case, we asked the Postal Service to give us updated, accurate figures for 1999, cost and revenue analysis for fiscal year 1999, which they did. At that time, we adjusted their original request by approximately $587 million, somewhere along in there, which included the ECI, which is the employment index. In the case, we usually did ECI minus one. In this instance, we gave them a full ECI. We took into consideration fuel costs, and we took into consideration the recently concluded labor contract negotiations, which they had brought up, that they would be going in there. So, the total package that we gave them——

Chairman THOMPSON. Also productivity fluctuations, too——

Mr. OMAS. Yes, and we added that to the case. That was in the decision we issued in November.

Chairman THOMPSON. You understand what Mr. Henderson is saying is that, after November, some circumstances changed. As I understand what he is saying, they brought oral testimony to your

[1] Responses from Postmaster General Henderson appears in the Appendix on page 108.

attention. You are saying they did not open up the record and supply it. What's the gap here? Where are we missing each other on this?

Mr. OMAS. There was no oral testimony, Mr. Chairman. They submitted to us a request, on remand, that we restore the contingency, which we had cut, and several other things. There were a total of about $1 billion, which they eventually restored. On the first remand, we offered them the opportunity to open up the case and we would try to expedite it. They declined to take that. They did a second request, and in the second request, they again declined to open up the case.

Chairman THOMPSON. Between that request and the second request, they came out with some revised projections, projecting a $2–$3 billion deficit for 2001. I think that was February of this year.

Mr. OMAS. That is right.

Chairman THOMPSON. Then they came back after that. They came back to the Commission again to ask for reconsideration.

Mr. OMAS. But they never presented new data. As far as we are concerned, as I said in my opening statement and in my full statement, we have no analyses of where they are losing the money exactly, and we must—we are charged with following the evidentiary record, and we had no record established as to what the new shortfalls, the loss of $2–$3 billion, were coming from.

Chairman THOMPSON. Mr. Henderson, do you take issue with any of that?

Mr. HENDERSON. I, frankly, do not know. When I say that, I say that from—I am not in the lawyering process in the Rate Commission. I do know that what was going on was obvious, and our appeal stated quite clearly what was happening in the Postal Service. These were not projections. This is what was actually happening. I mean, our revenues just went south, and we were saying to the Postal Rate Commission, "Look, we need more money. Your revenue projections are not accurate."

Chairman THOMPSON. See, the problem that a lot of us have is that these are very formal proceedings. Testimony is taken under oath, and you go through them every 2, 3, or 4 years. You go to all this trouble and all this expense, and take all this time in 10 months. You cannot, just in the middle of it or at the end of it, start sending stuff over the transom. If you have got stuff like this that is relevant and that is clear, you open up the proceedings. You make that a part of the record, because the Commission can only make their decision based on what is in the formal record.

Mr. HENDERSON. I agree with you, but I think if you were to examine the formal record, you would see that these things occurred before the record had closed. In other words, in our opinion, the sufficient evidence was on the record to justify the revenue requirement. I do not mean to say these things happened after the record closed.

Chairman THOMPSON. But you will agree that there was no formal opening up of the record or live witnesses presented with this new information?

Mr. HENDERSON. Yes, we did not feel that we needed it, and we did not want to start the process over again, so that the 10-month

period would re-click. We needed the money. As it is, the Governors went through the statutory process that allows them to implement the rate case after two submissions and denials by the Rate Commission.

Chairman THOMPSON. What happened and the reasons why you did it are two different things. I am just trying to get, first of all, at what happened. It would seem to me that having been turned down twice and with all these things happening, that you would dot the i's and cross the t's necessary to get this before the people. One might think you were not comfortable with your own projections. We talk about economic downturns and so forth. We know that, at the last quarter of last year, that we were growing at 1 percent. And at the first quarter of this year, we are growing at 2 percent. So it is hardly a recession, but you had your cost fluctuations, labor costs and fuel, and all of that in the record as of July of last year.

The issue is, when you were projecting a surplus, what circumstances changed so dramatically, so that you were, the next day, as it were, projecting huge deficits? I do not know why. There is obviously more here than meets the eye, and I am not smart enough to figure it out. It does not make a whole lot of sense to me.

Senator Cochran.

Senator COCHRAN. Mr. Chairman, you mentioned and one of the witnesses did, as well, the statutory borrowing limit of $15 billion, and that this might pose a problem in the near future. The borrowing up to the end of fiscal year 2000 has amounted to $9.3 billion. My question is, when do you think, Mr. Walker or Mr. Henderson or both, the Service is likely to reach its borrowing limit?

Mr. WALKER. My understanding is without an additional rate increase, above and beyond the one that has recently been approved by the Board of Governors, it would be in 2003.

Senator COCHRAN. Mr. Henderson, is that your estimate, as well?

Mr. HENDERSON. I think, yes, 2002, September 2002 or 2003. Yes, we will have a problem. Yes.

Senator COCHRAN. What is the practical consequence of that? If you reach that limit, what happens? Does Congress have to raise the limit or do we have to excuse——

Mr. HENDERSON. No, you have to raise the limit.

Senator COCHRAN. We have to raise the limit.

Mr. HENDERSON. If you look at the limit, $10 billion was set in 1970. We are in the year 2001, and it has only been raised to $15 billion. You say what do we do with the capital? What does that mean? We either raise capital through net income or we borrow it. We use capital to substitute for labor, that is to mechanize the Postal Service and to upgrade its infrastructure. So, it would put handcuffs on both the infrastructure upgrades and on the further mechanization or automation of the Postal Service.

Senator COCHRAN. Does the Board of Governors come into play here? Do you have a role to play in connection with the statutory borrowing limit?

Mr. RIDER. I believe they did. That was before my time.

Mr. HENDERSON. They approve, they being the Board of Governors, approves every capital expenditure of $10 million or over.

They have a role in spending the money. They have no role in setting the limit. That is purely the purview of Congress. That is a statutory——

Senator COCHRAN. And the board has to approve the borrowing?

Mr. HENDERSON. That is right, $10 million and over. That is correct.

Senator COCHRAN. Does the board have a position on whether or not this limitation ought to be changed?

Mr. RIDER. I am confused. The limit of $10 million we have is on projects we approve, capital projects we approve. Everything over $10 million, the board approves. Less than that, we do not. So, we have control over the capital expenditures that are being made.

Mr. HENDERSON. That is not a statutory limit. That is something they approve by bylaws.

Senator COCHRAN. We are mixing up two things.

Mr. RIDER. The $15 billion is set by Congress, as I understand it.

Senator COCHRAN. Mr. Walker.

Mr. WALKER. Mr. Chairman, the $15 billion limit on borrowing, the statutory limit, is an action-forcing event. That is going to occur sometime between 2002 and 2003, depending upon what actual experience is versus projected experience. That means, among other things, that we have some time to be able to come up with a set of comprehensive proposals. Obviously, one of the things that needs to be looked at is, part of that set of comprehensive proposals, is whether and to what extent that limit should be raised. But, at some point in time, as Postmaster General Henderson said, something has got to give.

When you end up coming up and you have negative cash flows, you can cut back your capital spending only so far. Some of that is only a timing difference. Some of that hurts your productivity improvement efforts. But, hopefully, what can happen is, if we can have a comprehensive set of plans or proposals that will consider what is to be done structurally before you hit this wall, because that is basically what the limit is. It is a wall that is going to require congressional action.

Mr. HENDERSON. That is right.

Mr. RIDER. Let me also indicate that the board does not favor raising the debt ceiling.

Senator COCHRAN. That was my question. That is what I was wondering.

Mr. RIDER. We do not favor raising. We would like not to do that, because if we raise the debt ceiling, we are raising our interest cost. That is just digging our hole a little deeper.

Senator COCHRAN. But if you do not raise the ceiling, what happens?

Mr. RIDER. We hope that we are going to be able to get reform and be able to operate within those constraints.

Senator COCHRAN. So you think it would be something that would put pressure on the Congress, to enact statutory reforms that are needed; is that correct?

Mr. RIDER. It is not a matter of putting pressure on. It is a matter of trying to get the job done so that we can stay in business.

Senator COCHRAN. Either that or the Postal Service can change the way it is managing its business, in order to keep the costs from increasing. Is that the other answer?

Mr. RIDER. Yes, that is, sir.

Senator COCHRAN. But why hasn't that been done?

Mr. RIDER. We are working on that now, sir.

Senator COCHRAN. One of the suggestions is that the costs of operating the business are out of control. I have heard that from critics who have come to see me, to say that it is time for the Postal Service to change the way it operates, so that it does not permit these costs to run out of control. Do you share that view, Mr. Rider?

Mr. RIDER. No response.

Senator COCHRAN. Can cost be cut further without statutory reforms or new authorities by Congress?

Mr. RIDER. We are in the process of cutting those costs just as much as we can, but 76 percent of our cost is labor—76 percent of our total cost is in labor. With that, we have to have the mailmen deliver to every house every day. We cannot cut back on that end. We are cutting back on headquarters and right on down to that. There is a point beyond which we can cut and still provide universal service and good service. Our customer satisfaction is quite high. It is in the 90 percent—93 precent——

Mr. HENDERSON. Right.

Mr. RIDER [continuing]. Percent customer satisfaction. In the capital business, part of the capital that we spend is for machinery which has a good ROI. Part of it is for facilities, and that gives us no ROI whatsoever. With adding on the volume of deliveries and the business that we are doing, it requires some of these antiquated facilities to be expanded, and we do not get an ROI for that.

Mr. WALKER. Mr. Chairman, if I may?

Senator COCHRAN. Mr. Walker.

Mr. WALKER. There is unquestionably an opportunity to be able to further cut costs and enhance productivity; however, without underlying structural reforms, you are not going to solve the problem. You are not going to solve the problem, because even if you end up spending more money on, for example, capital improvements, to enhance technology, to further automate a number of activities that might be able to be automated, in order to achieve the savings on that, you have got to do something with the labor costs. Under the current structure, it is difficult to do that. You also have to look at the infrastructure costs associated with the Postal Service. Ultimately, something has got to be done with that. We are not going to change evolving technologies. We are not going to change the competitive climate. The day of reckoning is going to come, and the question is when do we want to deal with it.

Mr. HENDERSON. I would add—I would agree with everything that Mr. Walker said, and just point out that last year we had the best productivity we have had in almost a decade, and we lost $199 million, primarily due to softening demand. This year, we have better-than-planned productivity, and we have costs under our plan, and we are losing money because of softening demand for postal products, in other words, our revenues, and we are not even being hit by the Internet today. As I said earlier, $17 billion of our $65

billion are bill payment and presentment. We all know it is not if, but when, that is going to go electronic. AT&T, for example, spends $1.75 or somewhere in that neighborhood, to send you a bill. If they could take that out of their cost structure, they could save $1 billion on the bottom line. Somebody is going to figure out how to do that. It is not going to happen tomorrow, it is not going to happen maybe 3 years from now, but it is going to happen. And, when it happens, you are going to have this same phenomenon of how does the Postal Service—as the Chairman mentioned, continue to do what is mandated under universal service, which is regularly scheduled mail delivery in urban and rural areas, 6 days a week across America, and opening post offices, keeping post offices opened—this is not a matter of good and evil, where it is not cost-effective? I will give you a classic example of that. Cape Cod has 7 townships, 53 post offices. President Kennedy had a great hand in that.

Chairman THOMPSON. Is that Massachusetts? Several of them ought to be closed.

Mr. HENDERSON. I will not go any further.

Senator COCHRAN. Thank you, Mr. Chairman.

Chairman THOMPSON. Thank you very much. Mr. Henderson, you talk about softening demand, but how much more is demand going to soften as these rates continue to increase?

Mr. HENDERSON. It is a problem. I agree with you.

Chairman THOMPSON. It is a Catch–22, isn't it?

Mr. HENDERSON. That is exactly right. It really represents what your opening statement said. It is a Catch–22.

Chairman THOMPSON. Let's get back to that for a minute. Mr. Walker, sitting here listening to this and listening to you, we have had this conversation before with regard to other governmental agencies. It seems to me that we have the same problems here that we have in most all governmental agencies—financial management problems, projections, trying to determine where you are, information technology problems, inability to use technology to help themselves, capital management problems, same kinds of difficulty in changing the culture. What we have done here is tried to combine a Federal agency entity with a private entity. To put them all together and give them characteristics of both.

It worked for a while and now it is not working anymore. Factors such as the technological revolution that is going on and because the bigger it gets, the more it begins to behave like other governmental entities. The Postal Service has 900,000 employees and we cannot seem to do very much about it. Obviously, part of that is because of the mandates. If we are going to keep all these post offices opened, somebody has got to be in them, and therein lies your employee situation to a great extent. Aren't these just the kind of characteristics that should not surprise us at all? The question is, in some sense, why haven't these problems happened sooner than they have?

Mr. WALKER. The Postal Service is a major and important case study in the two questions, as you know, Mr. Chairman, that I have raised before; and that is, now is the time that we need to ask what the government should do and how should the government do business in the 21st Century. We have to move beyond

incrementalism. Minor changes here, minor changes there—we have to recognize it is a new ballgame and we need to fundamentally re-examine some issues, not just with regard to the Postal Service, which is why we are here today, and it is very pressing and is very important, but in a whole range of areas, as well, because many of the challenges they face are shared by other entities. The Postal Service is supposed to achieve a specifically-defined mission and they are supposed to be self-supporting. So, it is more visible with them and it is more universal with them, because every American can identify with the Postal Service.

Chairman THOMPSON. Mr. Henderson, you were very candid in your statement awhile ago about how you saw the future. You saw a total or partially privatized Post Office. I said in my opening statement that everything ought to be on the table, including the question of the postal monopoly. What makes sense in the kind of world that we live in? You and I both know that if that were to come about, it is certainly going to have to get—well, that is not going to come about in short order, if ever. And whether it should or not is what we are going to be discussing here.

Mr. Rider, what would be your ideas, and Mr. Omas, also, what would be your ideas about something that might right the ship. Or, less than that, something that might be more politically doable than going in that direction? Is it worth the effort or should we just wait until we can revolutionize it before we do anything? I know that you have had certain reform ideas. Congress ought to do something about your labor situation. You ought to be able to raise rates whenever you want to, essentially, is the way I read it. Are those the only proposals that you have that might be done, that might be doable, less than privatization?

Mr. HENDERSON. Well, let me comment, because you raised the issue of privatization and monopoly. You cannot talk about monopoly without talking about universal service. Universal service is an obligation we have, and it is an obligation to go into areas of rural Tennessee and rural Mississippi, where we do not make any money. There are 40,000 post offices. The 26,000 smallest ones, it costs over $2 to take in a dollar. So, there is an infrastructure in place that is called universal service, that is there, and it is protected by a monopoly, and the two cannot—you cannot break one without breaking the other one.

You also have an issue of affordable rates. It costs the same amount of money to send a First-Class letter from Dresden, Tennessee, to Memphis, as it does to Anchorage, Alaska. That is something people accept as a fundamental right of living in America. So those are at the core of the U.S. Postal Service, and I agree with you, we are not going to break those tomorrow. You are not going to break them for a long time, and I think we all recognize that because of the impact on America.

As to the changes that can be made, yes, I think you can get price freedom, but as the chairman of the board pointed out, it is not just to raise prices, it is to lower prices. We make all our money—the Postal Service has a business cycle. It begins in September. Halfway through the year, we make all the money we are going to make. The last half of the year, we lose money. It is purely a function of volume. The first half of the year is robust. The Postal

Service is very efficient with that robust volume. Last half of the year, the volume goes away, and the Postal Service scrambles. It is impossible to say you are going to have 800,000 people in the first half of the year and 500,000 at the last half of the year. It does not work. There is a trade-off. Pricing freedoms—to change that business cycle in the last half of the year just like a retail store does. At the end of their business cycle, what do they do? They put their clothes on sale. That sounds strange, but we could incentivize mailers in that fashion. We could incentivize large mailers. Senator Collins talked about my good friend, Leon Gorman at L.L. Bean. If he gave us packages for Japan—well, Japan is a bad example. If he gave us packages for the United States in a certain fashion, we could give him certain discounts, having more freedoms. It is not just a matter—do not think of it as a model of just increasing prices, it is being able to adjust your prices.

In the final analysis, unless you change the accountability of the labor conflict solution at the Postal Service—I am talking about the wage increases—unless that has a different criteria, where the voice of the customer is heard, you are not changing anything. We can incentivize some growth, maybe. I actually question in my own mind how much we can incentivize. If you look back 30 years, mail volume growth has mirrored GDP. The correlation is almost a plus-one. So, if you do not get control over the work-hour cost——

Chairman THOMPSON. When you say have the customer have a bigger input in that, what are you talking about?

Mr. HENDERSON. Well, today, the customer has no input in it. It is an arbitrator who makes an independent decision, and he makes a decision without regard to what that impact will be on the price of postage. And if you look back 30 years, you see that the cost per hour and the revenue per piece, which is postage, correlate. In effect, you have an arbitrator driving postage rates.

Chairman THOMPSON. I have read where management-negotiated contracts were not much different than the ones that arbitrators——

Mr. HENDERSON. In the 1970's, that was true. In the 1970's, there was a belief that the postal workers were underpaid. I participated in the 1973, 1975, 1978, 1981, and 1984 negotiations, not as a principal, but as a person there. There was a belief in the 1970's that postal workers were underpaid, and they did put in provisions that were in the private sector at that time. In the 1980's, most of those provisions were taken out of the private sector, like cost-of-living allowances, for example. Some took strikes——

Chairman THOMPSON. Do all postal workers have COLAs?

Mr. HENDERSON. Yes, all craftworkers have COLAs, not management. Arbitrators have a tendency not to take out provisions that have been agreed to, and have been in there for long periods of time.

Chairman THOMPSON. What do you think, philosophically, as you go along? You are talking about things that might make you more competitive and Congress might be able to help you out in that regard. But, philosophically, what do you think, as you see these businesses around you who are beginning to provide some of the same services you are? They say they can do it, that they can com-

pete with one another and hold down prices, and maybe they can. What do you think about that? Should we shut them out? Should government be doing something that private enterprise can do? Should we carve certain portions of it out? In every other aspect of government, we are outsourcing an awful lot. What are your thoughts about that?

Mr. HENDERSON. I think that is actually the key question of the future of the Postal Service, and that is, what is the role of this quasi-government agency in the future, and should it compete where the private sector competes? I think the answer to that lies in the answer to another question, and that is, is a healthy Postal Service important to America? If the answer to the question is yes, then you do take steps to allow it to compete. If the answer to that is no, that a healthy Postal Service is not necessarily important, and you want to shrink it down—and there is a sale, there are two philosophical camps—then you do not do that and you just say size down. My own view is that a healthy Postal Service is very important to America and will be for a long time to come, and that the Congress ought to act in unison and make reforms that allow the Postal Service to be more competitive. But, you can choose a different ideology. That is legitimate.

Chairman THOMPSON. Mr. Rider, what are your thoughts on all of this in terms of what we can feasibly do?

Mr. RIDER. I agree, and I was just thinking on our labor situation. We are not allowed labor differentials in areas. Some of our postal workers in cities like New York, or Los Angeles, California, for example, are paid the same as those in Dresden, Tennessee, which is not right.

Chairman THOMPSON. I understand that your position is, or that there has been testimony to the fact, that there is a 23 percent wage premium, in terms of the private sector, that the postal employees have. Is that correct?

Mr. RIDER. I have not seen that figure. Have you?

Mr. HENDERSON. Well, we will provide that economic information, but I will say that we are not saying that postal workers are overpaid. We do not talk like that about our employees. Our employees do a very fine job every day and earn their money. We will let the economists fight over that.

Chairman THOMPSON. I agree. I used to be one of them. One of the multifaceted jobs I have had. When I dropped out of college 1 year to work a couple of different jobs, to save a little money, one of them where I worked was the Post Office in Lawrenceburg, Tennessee.

Mr. HENDERSON. Oh, really?

Chairman THOMPSON. Yes, I think the wage was about a dollar-and-a-quarter then, as I recall, but it was better than anybody else was making. Mr. Rider, do you have anything further?

Mr. Omas, do you have any thoughts?

Mr. OMAS. Well, Mr. Chairman, that is a bit of a difficult question. I think there may be certain areas in the Postal Service that could be privatized to make it more efficient, and I think all of that needs to be looked at in the overall—where the Postal Service is going to go and what we want the Postal Service to look like. But I go back to what I said earlier, to Senator Carper, is I think the

Postal Service's main business is its core business, and that is the delivery of mail. They have the network. They have the ability and there are companies now who are doing a great deal of work-sharing, which I think saves money for the Postal Service. We think it does. They bring their mail down to sectional center facilities for drop-shipping. In other words, they take a lot of work out of processing the mail. So maybe encouraging that is something the Postal Service should look at expanding.

Chairman THOMPSON. Senator Cochran.

Senator COCHRAN. One final question. There is a requirement in the statute that you have to break even, not that you have to make a profit. It is still the Postal Service, not the Postal Business, in the statute. Should either one of these concepts be changed in the comprehensive reform that we undertake?

Mr. HENDERSON. That is an interesting question. I really do not have an answer to that question today. I will say it is much easier to manage a business for profit than it is to break even. You say how does that make a difference? Well, in 1997, in July, we were given the authority to raise rates, and because we were making so much money at that time, we decided to postpone that decision of implementing that rate increase until January. If we would have been operating for a profit, we would have put those rates in in July, and just increase our profit. Because we were making so much money, we decided to postpone it for a year.

So, it does have an impact on you. I think, from a public policy point of view, for our customers, it is probably a good notion to have a not-for-profit Postal Service. From a management point of view, I would much rather manage an organization that runs for profit than one that does not run for profit. It is much easier.

Mr. RIDER. May I add that we do need to have some way—if we are going to be breakeven, we have to have some way of raising capital to take care of our capital needs, both facilities and machinery. If we are just in a breakeven situation, the only thing we can do there is fund it out of depreciation, and depreciation does not take care of even replacement today.

Senator COCHRAN. Mr. Walker, do you have any observations about that issue?

Mr. WALKER. I think it is one of the issues that has to be looked at as part of comprehensive reform. In my view, in sitting here and listening today, to me, there were several things that were evident right off. First, there is a need for additional transparency and accountability with regard to the Postal Service's financial and operating results and projections. There is a need for enhanced communication and coordination between the board, management, the unions and the Postal Rate Commission on these issues. There is a need to try and consider additional contingencies, with regard to variances that could exist with regard to either the revenue side or the cost side in order to minimize the frequency of postal rate increases. There is a need to continue to push, to try to improve productivity and minimize cost and minimize rate increases, but there is also a need to get on with the effort to develop a comprehensive transformation plan, because, in the end, we are not going to be able to change the trends that are impacting the Postal Service; the technology, the competition. In the end, there is going

to have to be much more comprehensive change to deal with the underlying structural problems.

Senator COCHRAN. Thank you, Mr. Chairman.

Chairman THOMPSON. I think that pretty well says it all. That is probably a good place to end right there. I think what you have laid out for us is a job for Congress and a job for the Postal Service. Clearly, we have laid some requirements on the Postal Service that are important. Universal service is important and it is going to remain so, regardless of what it costs, probably. Mr. Rider talks about the need to raise capital. The direction we are going in, you are going to be raising it right up here, before the Appropriations Committee.

I might just ask Mr. Walker, what is the significance—if they are about to reach their debt limit of $15 billion—if we continue anywhere near where we are going right now? I think the picture is probably a little worse than what we are laying out because of these assumptions that are not going to pan out, but let's say next year, or the year after that, we reach the debt limit, what is the significance of that? Obviously, they will have to start paying expenses in cash. I mean, in terms of retirement payments and all of that, that is a significant landmark; isn't it? Congress could, obviously, come in and throw a few billion dollars into the pot, but, short of that——

Mr. WALKER. You could take some fairly dramatic and, some would argue, Draconian actions. You could freeze all capital spending. You could end up engaging in massive layoffs for people who you have the ability to lay off. I do not think any of these are desirable. You could end up taking some short-term actions that might end up dealing with the problem in the short-term, but it could exacerbate your long-term challenge. We have a window of opportunity here, because one of the issues that the Congress is going to have to deal with—it is going to have to deal with this debt limit issue, the way things are going right now. So one of the things we hopefully will do is to be able to take a look at this window of opportunity, do what you can in the context of current law, and come up with a more fundamental transformation plan, including any necessary restructuring, before you hit that limit.

Chairman THOMPSON. And, as a part of that, and because it needs to be done, and because it can help the bottom line, and because it gives us the political ability to get something more done, the Postal Service is going to have to do something better. In terms of productivity, in terms of managing its costs, in terms of financial management and things of that nature the Postal Service must do better. I think it is not to lay blame on anyone, it is just a matter of fact.

I hate to leave on that note, as a matter of fact, especially with Mr. Henderson. You have given a lot of good public service to your country over the years, and I want you to know we appreciate it. As I say, this is probably not the best way to go out, unless you have another hearing or two you are going to have to go to on the other side.

Mr. HENDERSON. I enjoy the hearings. I would like to enter into the record the statement of Karla Corcoran, Inspector General.[1]

Chairman THOMPSON. You are in a position now, and will be, to have a perspective to look back on all this. To really give some candid advice to us, as to some things that we can do and maybe as to what your successor can do, some of the things you have done and some of the things you wish you had done. Thank you for your service, and, gentlemen, thank all of you as we proceed to try to make progress in this area.

The record will remain open for a week after the close of the hearing. If there is nothing further, we are adjourned.

[Whereupon, at 12:26 p.m., the Committee was adjourned.]

[1] The prepared statement of Ms. Corcoran appears in the Appendix on page 118.

APPENDIX

PREPARED STATEMENT OF SENATOR BYRON L. DORGAN, A U.S. SENATOR FROM THE STATE OF NORTH DAKOTA

Mr. Chairman and Members of the Committee:

I thank you for the opportunity to share my views with you. As you know, the Postal Service recently announced that it will be facing a projected deficit in the range of $2 to $3 billion during fiscal year 2001.

A number of options have been proposed to help the Postal Service become more financially stable. Construction projects, affecting more than 800 postal facilities, were put on hold earlier this year. Also, last week the Postal Service announced yet another set of rate increases in an effort to curtail the projected deficit. In April, the Board of Governors called for a study of one of these proposals, namely, to cut delivery by the Postal Service to five days a week. This is particularly troubling to me because of the negative impact this would have on rural areas.

I understand the many challenges facing the Postal Service. Not only are some costs rising—such as fuel prices for delivery vehicles—but other methods of communicating and doing business have caused a decrease in the volume of First-Class mail. Many people are using the Internet to pay their bills, to go shopping, and to contact their friends and family.

However, not all Americans have enjoyed the benefits of these technological advances. People in rural areas, like much of North Dakota, are hampered by limited access to these technologies. These people depend heavily on the Postal Service.

It seems to me that eliminating Saturday mail service affects rural areas disproportionately. To those in rural areas, Saturday mail service gives people one more day to receive mail, conduct business, order and receive prescription drugs, send bill payments, and read the news from local and national newspapers. Furthermore, while those in urban areas have easy access to other delivery services, such as the United Parcel Service (UPS) or Fed Ex, it is often not convenient for those in rural areas to use these services or they may not be offered at all. Doing away with Saturday delivery from the Postal Service is just another way that rural America would be left behind.

It's also important to remember that taking away Saturday delivery won't take away the mail that is now being delivered on Saturday. Instead, mail carriers would be forced to deliver a larger volume of mail each day. Anytime we have a national holiday, the mail backs up, creating delays and higher workloads for carriers. Carriers may be forced to work overtime, just to keep up with the steady stream of mail.

The idea to reduce mail delivery to five days a week is not a new one. Back in the early 1980's, there were substantial reforms relating to the Postal Service, and at that time, some suggested that delivery service be reduced to five days a week. Federal subsidies for the Postal Service were greatly reduced in the budget, and Members of Congress were looking for ways to cut costs. But five day service was a bad idea then, and it's a bad idea now.

In response to those proposals, language was inserted into the Treasury/Postal Appropriations bill, requiring the Postal Service to maintain service at 1983 levels. As the Ranking Member of the Senate Subcommittee on Treasury/Postal Appropriations, I intend to work with my colleagues to ensure that this language is retained.

Limiting mail delivery to five days a week would be detrimental to rural communities which must already overcome the obstacle of isolation. I will work to prevent this misguided proposal to cut delivery service from becoming reality. I commend this Committee for holding this hearing and I look forward to working with you on this important issue.

United States General Accounting Office

GAO

Testimony

Before the Committee on Governmental Affairs
and its Subcommittee on International Security,
Proliferation, and Federal Services
U.S. Senate

For Release on Delivery
At 10:00 a.m. EDT
Tuesday,
May 15, 2001

U.S. POSTAL SERVICE

Financial Outlook and Transformation Challenges

Statement by David M. Walker
Comptroller General of the United States

GAO-01-733T

Mr. Chairman and Members of the Committee and Subcommittee:

We are pleased to be here today to participate in this joint hearing on the financial outlook and transformation challenges of the U.S. Postal Service (the Service). Overall, the Service faces major challenges that collectively call for a structural transformation if it is to remain viable in the 21st century. Your Committee and Subcommittee have expressed concern with the Service's deteriorating financial outlook. In my testimony today, I will focus on the Service's current financial outlook, actions the Service has taken or planned, and the transformation issues that will need to be addressed.

Summary

A structural transformation of the Service is called for because the Service faces major financial, operational, and human capital challenges. It is at growing risk of not being able to continue providing universal postal service vital to the national economy at reasonable rates while remaining self-supporting through postal revenues. Accordingly, in April 2001, we placed the Service's transformational efforts and long-term outlook on our High-Risk List. This inclusion on our High-Risk List will focus needed attention on the dilemmas facing the Service before the situation escalates into a crisis where the options for action may be more limited and costly.

Key factors contributing to our decision to place the Service's transformational efforts and long-term outlook on our High-Risk List included the following:

- The Service's financial outlook has deteriorated significantly, its borrowing is increasing, and the Service's debt is approaching the $15 billion statutory ceiling without any debt reduction plan. Also, the large number of retirements expected over the next several years will place even more pressure on the Service's expenses and its need for cash.
- The Service recently deferred capital investment to conserve cash, thus delaying needed infrastructure improvements. These deferrals appear likely to continue.
- In March 2001, the Postal Service's Board of Governors wrote the President and Congress asking for a comprehensive review of postal laws. The Board said "We have unanimously concluded that the present statutory scheme puts at serious risk our ability to provide consistent and satisfactory levels of universal service to the American people, generally recognized as delivery to every address every day, at uniform, affordable rates."
- Potential losses in First-Class Mail volume over the next decade could create large financial deficits, leading to a situation where universal postal service could ultimately be threatened, prices would likely increase at a much faster rate, and other options would need to be explored.
- The Service is subject to several statutory and other restrictions that serve to limit its transformational efforts (e.g., binding arbitration requirement, the rate-setting process, and facility closure restrictions).
- The Service has also had periodic conflicts with some of its key stakeholders including postal unions and the Postal Rate Commission. We have noted longstanding

labor-management relations problems that have hindered improvement efforts, including three labor agreements that expired in November 2000 and may now be resolved through binding arbitration. In addition, the Postal Service and the Postal Rate Commission have had longstanding disagreements concerning pricing decisions.
- Finally, two key leadership positions need to be filled relating to postal operations and rate setting (Postmaster General and Chairman of the Postal Rate Commission).

Although the Service has announced some steps to address its growing challenges, it has no comprehensive plan to address its numerous financial, operational, or human capital challenges. In April 2001, we recommended that the Postal Service develop a transformation plan in conjunction with Congress and other stakeholders that would address the key transformation issues facing the Service.[1] Service officials told us that they generally agree with the recommendation. I recently met with the Deputy Postmaster General, and we discussed ways that the Service could implement it.

We appreciate the difficulty of this task, given the long-standing nature of the structural problems and major differences in stakeholders' views. But the sense of urgency is growing. The basic statutory framework that governs the Postal Service has not changed since 1970, despite the fact that developments in technology and a more competitive marketplace provide more communications and delivery choices to businesses and consumers. The Service's ability to provide universal postal service as we know it today will be increasingly threatened unless changes are made, both within current law and to the legal and regulatory framework that governs the Service.

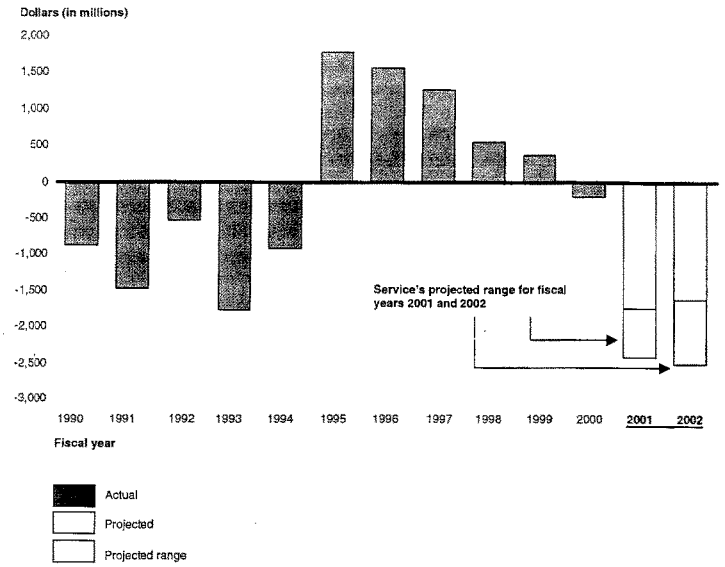
What is the Service's Current Financial Outlook?

The Service is projecting significant losses over the next 2 years, although the full extent of the losses is unclear. The Service currently estimates that its fiscal year 2001 deficit will range from $1.6 billion to $2.4 billion and also estimates that its deficit will be $1.5 billion to $2.5 billion next fiscal year, assuming no further increase in postal rates next year. If such deficits occur, they could be the largest that the Service has incurred since fiscal year 1993 (see fig. 1).

The Service's latest deficit projections for fiscal years 2001 and 2002 incorporate the expected impact from its Board of Governor's recent decision to raise most postal rates on July 1, 2001 (the rate for single-piece First-Class mail of up to 1 ounce will remain at 34 cents). Service officials estimate that the higher rates will increase its revenues by about $200 million in fiscal year 2001 and about $975 million in fiscal year 2002.

[1] *U.S. Postal Service: Transformation Challenges Present Significant Risks* (GAO-01-598T, April 4, 2001).

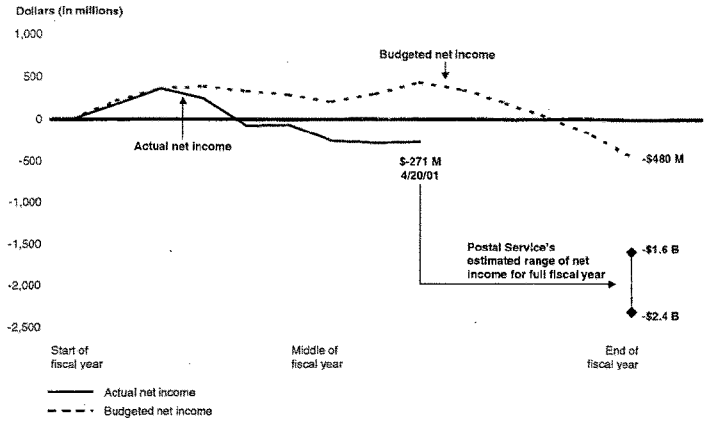
Figure 1: Postal Service Net Income From Fiscal Year 1990 through 2002



Source: U.S. Postal Service.

The Service's estimated fiscal year 2001 deficit of $1.6 to $2.4 billion far exceeds the $480 million deficit built into the Service's budget that was approved last November. About $271 million of the Service's current deficit projections were based on reported losses through the end of the Service's accounting period ending April 20, 2001, and the rest is based on projected losses for the rest of the fiscal year (see fig 2).

Figure 2: The Postal Service's Net Income for Fiscal Year 2001



Source: U.S. Postal Service.

The Service's current deficit estimate of $1.6 billion to $2.4 billion for fiscal year 2001 is roughly half a billion dollars lower than the Service's estimate we cited in our April testimony of a $2.1 billion to $3.1 billion loss. According to Service officials, the less pessimistic outlook is due to three factors. First, the Service reports making additional progress in controlling costs, and expects that progress to continue for the rest of the fiscal year. Second, the Service expects to gain revenues as a result of its recent decision to raise most postal rates on July 1, 2001. Third, the Service updated its projections about the potential effect of the soft economy on postal revenues for the rest of the fiscal year.

Although the Service appears headed for a large deficit in fiscal year 2001 and has explained its basis for the estimates to us, we believe that too many uncertainties exist to predict the size of this year's deficit at this time with any precision. The Service's financial outlook is a moving target and may change, depending on the resolution of uncertainties that could affect its revenues and expenses for the rest of this fiscal year. For example, the impact of the economy on postal revenues remains somewhat unclear, as are the financial implications of the ongoing contract negotiations between the Service and three of its major labor unions. We will continue to review the Service's financial condition and will report again to Congress on this matter. Regardless of the exact size of the Service's deficit, the severity of the Service's financial situation is highlighted by the fact that a large deficit is likely to occur despite two rate increases in the same year.

Components of the Service's Projected Deficit for Fiscal Year 2001

The Service's projected deficit for fiscal year 2001 can be divided into the following categories: (1) $271 million in reported losses through the end of the Service's accounting period ending April 20, 2001, (2) $911 million in budgeted losses for the rest of the fiscal year, (3) $120 million in expenses projected to *exceed* budgeted targets for the rest of the fiscal year, (4) $155 million in revenues projected to *fall below* budgeted targets for the rest of the fiscal year because the Service did not initially receive the full rate increase it had requested, and (5) $150 million to $950 million in revenues projected to *fall below* budgeted targets for the rest of the fiscal year due to the soft economy and its impact on mail volume and revenues (see fig. 3). The $800 million deficit range reflects the Service's judgment that the soft economy will have an uncertain impact on its revenues.

Figure 3: Changes in the Postal Service's Financial Outlook for Fiscal Year 2001

	Budgeted	Current
Reported Net Income: As of 4/20/01	$431 M	-$271 M
Originally Budgeted Net Income: 4/21/01 - FY-end	-$911 M	-$911 M
Expense Adjustments to Net Income: 4/21/01 - FY-end		-$120 M
Revenue Adjustments to Net Income: 4/21/01 - FY-end		-$155 M
Subtotal		***-$1.5 B***
Other Revenue Adjustments to Net Income: Soft Economy - 4/21/01 - FY-end		-$150 M to -$950 M
Net Income	-$480 M	-$1.6 to -2.4 B
FY 2001 Revised Deficit $1.6 to $2.4 B		

Legend: Dollars in millions (M), billions (B).

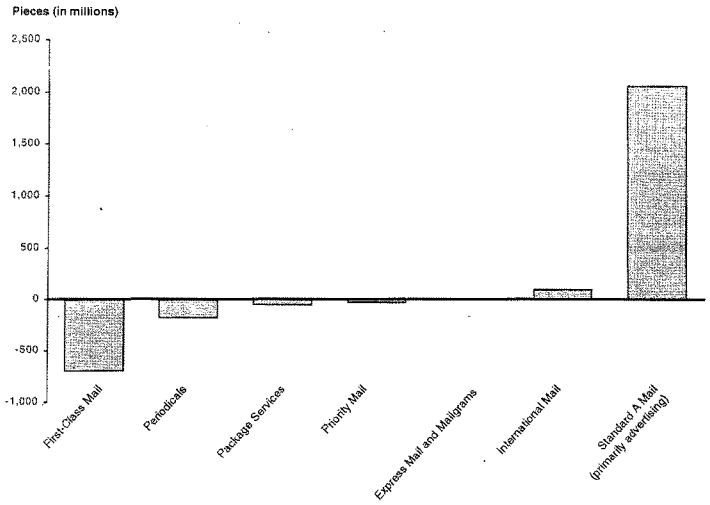
Source: GAO presentation based on U.S. Postal Service estimates, which are subject to change.

Reported Losses for the First Part of Fiscal Year 2001

As figure 3 shows, the Service reported that its loss for the first part of this fiscal year through April 20, 2001, was $271 million. This reported amount is not audited and is subject to change. Historically, the Service's financial performance tends to be stronger in the first part of the fiscal year, which includes the busy holiday mailing season. The Service budgeted for a $431 million surplus through April 20, therefore, its net income fell $702 million below this target. To put some perspective on the Service's income estimates, in the first part of last fiscal year, the Service achieved $1.1 billion in net income but ended the year with a net loss of $199 million.

Through April 20 of fiscal year 2001, total mail volume continued to grow, and it was also greater than that planned for by the Service in its fiscal year 2001 budget. In particular, Standard A advertising mail volumes grew more rapidly than the Service had expected. At the same time, however, some mail volumes were less than what the Service had planned for in its budget, particularly First-Class Mail and Priority Mail volumes (see fig. 4).

Figure 4: Mail Volume for FY 2001 Through April 20, 2001 Compared to Budgeted Levels



Source: U.S. Postal Service.

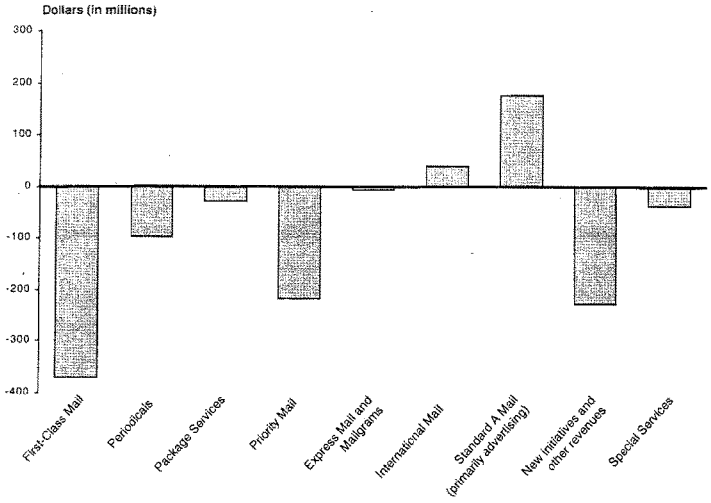
These mail volume shortfalls contributed to the Service's mail revenues being less than budgeted for in the first part of fiscal year 2001. First-Class and Priority Mail, when combined, account for close to two-thirds of the Service's mail revenues and generate revenues that pay for approximately three-quarters of the Service's overhead costs. Thus, the Service cites the shortfalls in First-Class Mail and Priority Mail volume as important reasons that its total revenues have fallen short of budgeted targets. The Service has also noted that Standard A advertising mail is lower margin mail in that each mail piece generates less money toward overhead costs than each piece of First-Class Mail and Priority Mail.

In addition, the Service has estimated that the decision by the Postal Rate Commission to not recommend the full rate increase requested by the Service will lower its total revenues by $390 million this fiscal year, including $235 million in the fiscal year through April 20.

Further, the Service incurred a shortfall of $228 million from other types of revenue that included a $138 million shortfall in planned revenue from e-commerce, advertising, and retail initiatives. These initiatives generated only $2 million in revenues in fiscal year 2001 through April 20. The Service explained that as experience with its new ventures progresses, it has become clear that the business plans were overly aggressive.

Figure 5 shows the Service's total revenues, including shortfalls in various mail categories, special services,[2] and other types of revenue.

Figure 5: Revenues for FY 2001 Through April 20, 2001 Compared to Budgeted Levels



Source: U.S. Postal Service.

The Service's expenses in fiscal year 2001 through April 20 were about the same as its budgeted target of $41.9 billion—with reported expenses $50 million below this target, a difference of 0.1 percent. During this period, First-Class Mail and Priority Mail volumes fell below expected levels. Service officials have told us that the cost of handling First-Class Mail and Priority Mail did not decline commensurate with the decline in volume because it is difficult to make such a short-term adjustment. Moreover, the Service incurred additional costs to handle higher-than-expected increases in other mail volumes, particularly Standard A advertising mail. Thus, the Service's overall workload was higher than it had budgeted for. As a result, some compensation and other costs were reported to be higher than budgeted, but these additional costs were fully offset in the first part of the fiscal year by cost reductions in other areas.

[2] Special services include registered and certified mail, postal money orders, and post office boxes, among other things.

Budgeted Losses for the Rest of Fiscal Year 2001

In its fiscal year 2001 budget, the Service estimated that it would incur a $911 million deficit for the rest of the fiscal year after April 20, 2001. When this amount is added to the $271 million deficit incurred in the first part of the fiscal year, the Service would lose nearly $1.2 billion in fiscal year 2001. This amount does not include developments in the rest of the fiscal year that the Service projects will have a negative impact on its net income, which are detailed below.

Expenses for the Rest of Fiscal Year 2001 in Addition to Those Previously Budgeted

The Service currently projects that its expenses for the rest of fiscal year 2001 will be $120 million greater than budgeted, including the following:

- *Transportation and energy expenses:* The Service continues to expect transportation and energy expenses to exceed budgeted amounts for the rest of the fiscal year due to rising prices and cost passthroughs from contractors. Postal officials are concerned that fuel and energy prices may increase substantially in the near future, which also may increase inflation and future cost of living adjustment payments to Service employees and retirees. In addition, unbudgeted transportation-related costs will be incurred for start-up costs associated with the Service's new multiyear contract with FedEx to transport Priority Mail and Express Mail.
- *Other expenses:* Workers' compensation expenses are projected to be about $50 million over budget for the rest of fiscal year 2001, according to the Service, and to reach about $1 billion for the full fiscal year. The Service also expects a small impact to result from recent increases in "terminal dues" paid to foreign postal administrations to deliver outbound U.S. international mail that were not factored into the Service's budget.

Revenue Shortfalls for the Rest of Fiscal Year 2001

The Service projects revenues will be below its budgeted targets for the rest of the fiscal year for two reasons. First, the Service budget assumed that it would receive the full rate increase it had requested. However, this did not occur. On January 7, 2001, the Service implemented under protest a smaller-than-requested increase that the Postal Rate Commission had recommended (including a 1-cent increase in the basic First-Class stamp rate to 34 cents). The Service subsequently decided to override the Commission's recommendation on May 7, 2001, and raise rates again on July 1, 2001, to generate the revenues it had originally requested (leaving the First-Class stamp rate at 34 cents). Thus, the Service projects that revenues for fiscal year 2001 will be $390 million below what its budget had assumed—$235 million, as a result of the shortfall, through April 20 and $155 million, as a result of the projected shortfall, for the rest of the fiscal year.

Second, the Service projects that from April 21 through the end of the fiscal year, its revenues will fall below budgeted targets by $150 million to $950 million due to the soft economy and its impact on postal revenues. This range reflects the Service's uncertainty about the length and severity of the economic slowdown.

Other Factors May Add to the Service's Deficit for Fiscal Year 2001

The Service's revenues will likely be lower than budgeted targets for the rest of the fiscal year and its expenses will likely be higher than budgeted targets for a variety of reasons:

- The Service is unlikely to achieve its ambitious $289 million revenue target for the full fiscal year for revenues from e-commerce, advertising, and retail initiatives, given that these initiatives generated only $2 million in fiscal year 2001 through April 20 – a shortfall of $138 million from the Service's budget target for this period. In addition, the Service may not achieve its $454 million target for other miscellaneous revenues, given that these revenues fell $90 million short of the budget target for the first part of the fiscal year. The Service's historical difficulty in making profits from its new products and services suggests the Board of Governors may wish to look at the Service's policies and practices for determining when the Service should enter into new ventures and when such ventures should be discontinued.[3]
- Although the Service reports that compensation expenses have been below budgeted targets in recent weeks and that it imposed a hiring freeze on all headquarters positions in April, it is still unclear whether the Service's compensation expenses will achieve the budgeted target for the full fiscal year because these expenses were $132 million over budget for the fiscal year through April 20.
- The Service may incur additional expenses depending on the outcome of ongoing litigation regarding its previous contracts with Emery Worldwide Airlines Inc., which sorted and transported Priority Mail until early 2001.
- The Service will also need to continue to control expenses such as those for supplies and services so that below-budget expenses for the first part of the fiscal year are not simply deferred to a later time.

Additional Information Could Help Explain the Service's Changing Financial Outlook

The Service has made numerous revisions to its estimated net income for fiscal year 2001 with little or no public explanation, creating confusion and raising concerns about its ability to generate timely and reliable financial information. The significant shift in the Postal Service's financial outlook in early 2001 came as a surprise to a variety of key stakeholders, with many concerns raised after the Service revised its estimated net income for fiscal year 2001 from a $480 million deficit last November to a $2 billion to $3 billion deficit this February. Currently, the Service estimates a $1.6 billion to $2.4 billion deficit for fiscal year 2001 (see table 1).

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[3] *U.S. Postal Service: Development and Inventory of New Products (GAO/GGD-99-15, Nov. 24, 1998; and U.S. Postal Service: Postal Activities and Laws Related to Electronic Commerce (GAO/GGD-00-188, Sept. 7, 2000).*

Table 1: Postal Service Estimated Net Income for Fiscal Year 2001

Date	USPS Estimate of Net Income for Fiscal Year 2001	Source
1/12/00 – USPS requests rate increase.		
2/8/00	$500 million surplus	USPS preliminary performance plan for FY 2001
9/30/00	$150 million surplus	USPS 5-Year Strategic Plan for FY 2001-2005
10/6/00	$480 million deficit	USPS final performance plan for FY 2001
11/13/00 – Postal Rate Commission recommends lower-than-requested rates.		
11/14/00	$480 million deficit	USPS-approved budget for FY 2001
12/4/00	$960 million deficit	Postmaster General (Federal Times)
12/4/00 – USPS states it will implement Commission-recommended rates under protest.		
12/18/00	$1.3 billion deficit	USPS Chief Financial Officer
1/7/01 – Higher rates go into effect.		
2/7/01	$2-$3 billion deficit	USPS revised budget submission to OMB for FY 2001
5/7/01	$1.6-$2.4 billion deficit	USPS estimate provided to GAO
5/7/01 – USPS Board of Governors overrules the Commission; most rates will increase again on July 1, 2001, to generate the revenues USPS originally requested. (The basic First-Class stamp rate remains at 34 cents.)		

Source: U.S. Postal Service and Federal Times.

Postal stakeholders have raised concerns about the reliability of the Service's estimates of its net income for fiscal year 2001. In addition, some stakeholders have said that they do not understand how the Service's financial outlook rapidly worsened to such a great extent from last fall to early this year. To further better understanding, the Service should provide more complete and readily accessible information to Congress and the public on changes in its financial outlook. For example:

- Last fall, the Service did not publicly explain why its published estimates of net income for fiscal year 2001 changed by $630 million over a 1-week period. Specifically, the Service revised its estimate of net income for fiscal year 2001 from a $150 million surplus in its 5-Year Strategic Plan dated September 30, 2000, to a $480 million deficit in the Service's final annual performance plan for fiscal year 2001 dated October 6, 2000. The final plan did not explain why the Service's financial outlook changed over this period. Service officials told us that the change was due to its decision to lower estimated revenues for fiscal year 2001.
- Further, although Service officials have provided explanations of changes in the Service's financial outlook in open forums—such as monthly Board of Governor's meetings, meetings with mailer groups, and in testimony before Congress—these explanations have not been as readily accessible to those not in attendance.

Greater transparency is needed in connection with the Service's financial and operating results and projections. To this end, in April 2001, we recommended that the Service provide summary financial reports to Congress and the public on a quarterly basis. These reports should present sufficiently detailed information for stakeholders to understand the Service's current and projected financial condition; how its outlook may have changed since the previous quarter; and its progress toward achieving the desired results specified in its comprehensive plan to address its financial, operational, and human capital challenges. Service officials told us that they generally agree with our

recommendation and are considering how to best implement it. On May 11, 2001, the Deputy Postmaster General, the Chief Financial Officer, and I met to discuss how to proceed in this area. As we discussed in that meeting, one way the Service could achieve greater transparency would be to post this information on its Web site to facilitate timely communication of the information.

The Service's Financial Outlook for Fiscal Year 2002

The Service currently estimates that its deficit for fiscal year 2002 will be $1.5 billion to $2.5 billion. This range is about $1 billion less than the Service projected earlier this year because the Service has decided to implement higher rates for most categories of mail on July 1, 2001. Many uncertainties exist that could affect the Service's net income for fiscal year 2002. For example, the estimated deficit for fiscal year 2002 assumes no further increases to postal rates in fiscal year 2002. However, the Service's Board of Governors directed postal management to prepare a request for another rate increase. If the Service seeks another rate increase to be implemented during fiscal year 2002, its deficit projection could change.

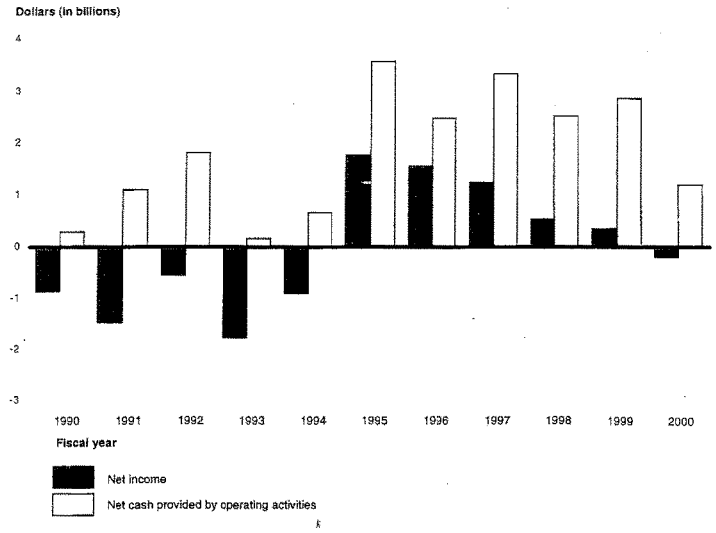
The Service Has Growing Cash Flow and Debt Challenges

The Service's declining net income and current losses are putting pressures on its cash flows from operations (the funds that remain after the Service pays its expenses) and debt situation. The Service has been generating less cash flow from operations that are used for capital expenditures and debt repayment. Therefore, the Service has relied increasingly upon debt to finance its capital expenditures and expects to reach its $15 billion statutory debt limit by the end of fiscal year 2003, assuming no further increases in postal rates after July 1, 2001. Under this scenario, the Service could pay bills only through its cash on hand plus additional cash generated from operations until outstanding debt declines.

As shown in figure 6, the Service's cash flows from operations are typically significantly greater than its net income. The primary reason for the difference is that net income is calculated on the accrual basis of accounting[4] and includes accrued expenses, such as depreciation expense, that do not use cash.

[4] Under the accrual basis of accounting, revenues are recorded when earned, and expenses are recorded when incurred, even if these activities are not concurrent with the related receipt or outlay of cash.

Figure 6: Postal Service Net Income and Cash Flows From Operations



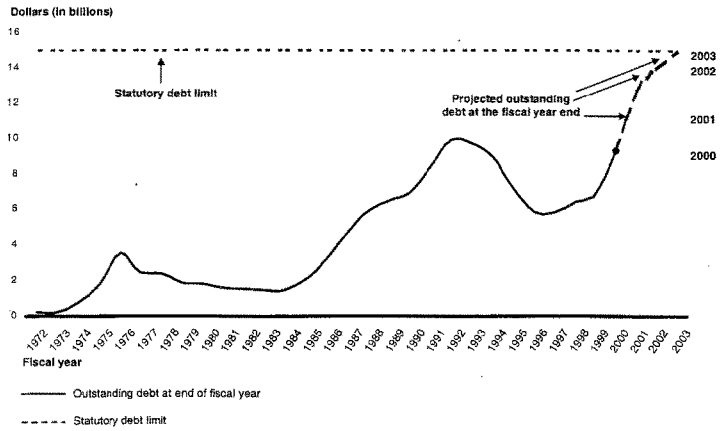
Source: U.S. Postal Service.

The Service is currently experiencing some cash flow pressure because of its deficits, but it anticipates it will make all of its fiscal year 2001 year-end payments for retirement expenses and worker's compensation. To avoid a cash shortage during fiscal year 2001, the Service has placed a freeze on capital commitments that will affect more than 800 facility projects this year. Last year the Service had planned capital commitments of $3.6 billion for fiscal year 2001, but Service officials recently announced reductions in this area and told us they now anticipate a reduction to about $1.7 billion in capital commitments this fiscal year. Preliminary budget plans for fiscal year 2002 would reduce capital investment from originally planned levels. To the extent that a freeze on needed capital investments is required to conserve cash, it may simply change the timing of such expenses and raise the final cost, while deferring any related expected benefits.

The Service has mounting debt and many billions of dollars in liabilities for future retirement and worker's compensation expenses. These liabilities have increased in part because the Service was statutorily mandated to assume responsibility for funding all cost of living adjustments and health benefits for its retirees since July 1, 1971. For the remainder of this decade, these liabilities will continue to have an increasing impact on the Service's future cash flows, placing the Service under growing financial pressure.

The amount that the Service borrows on an annual basis is largely determined by the difference between its cash flows from operations and the amount it spends on its capital investments. The Service has experienced a net increase in outstanding debt at the end of each fiscal year since 1997; and beginning in 1998, the Service's cash outlays for capital expenditures exceeded its cash flows from operations. The Service's debt increased from $5.9 billion at the end of fiscal year 1997 to $9.3 billion at September 30, 2000. The Service has an annual limit of increasing its outstanding obligations by $3 billion (that includes a $2 billion limit for capital improvements and a $1 billion limit to defray operating expenses). Assuming that the Service's latest financial outlook is on target, the Service would reach its $15 billion statutory borrowing limit by September 30, 2003 (see fig. 7).

Figure 7: Trends in Postal Service Debt

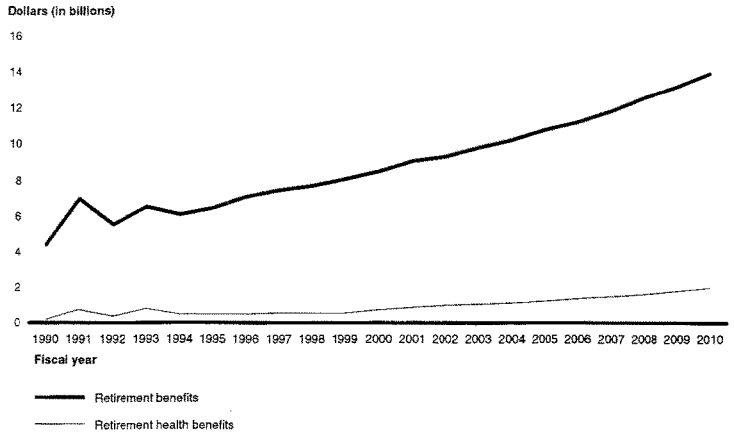


Source: U.S. Postal Service.

Growing Retirement Expenses

The Postal Service's retirement-related expenses have increased in recent years, and these trends are expected to continue (see fig. 8). The Service's retirement liabilities translate into annual payments from the Service to the federal government's Office of Personnel Management, which administers payments to retirees. The Service has been making these payments at the end of each fiscal year. According to the Service, these payments are estimated to increase by $554 million in fiscal year 2001 to $9.1 billion and are projected to reach $14.0 billion in fiscal year 2010. In addition, the Service has estimated that its retiree health benefit premium expenses will increase by $114 million in fiscal year 2001 to $858 million, and the Service has projected that these expenses will reach about $2.0 billion in fiscal year 2010.

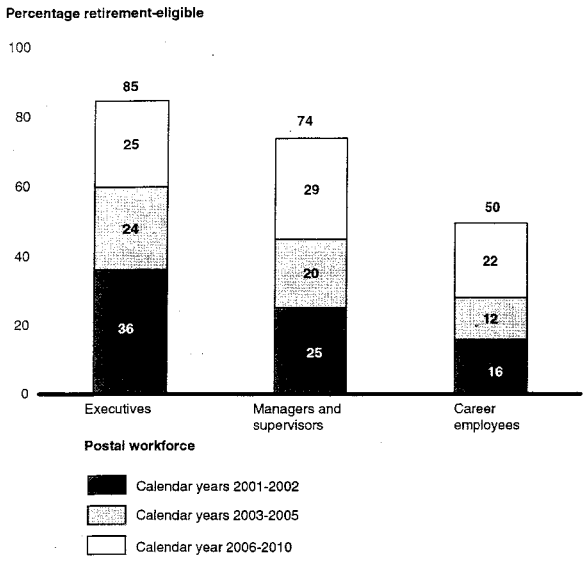
Figure 8: Postal Service Projects Increases in Retirement-Related Expenses



Source: U.S. Postal Service.

The Service has projected that among its current employees as of October 2000, about 130,000 postal employees were already eligible, or will reach eligibility, for regular retirement in calendar years 2001 and 2002. This projection includes 36 percent of executives, 25 percent of managers and supervisors, and 16 percent of the career workforce. By calendar year 2010, 85 percent of postal executives, 74 percent of postal managers and supervisors, and 50 percent of the career workforce will reach retirement eligibility, according to Service projections (see fig. 9). Although many employees do not retire immediately, the increasing number of postal employees who will become eligible to retire in the remainder of this decade raises questions about succession and workforce planning. If retirees are not replaced with the appropriate number of employees possessing the needed skills, the resulting loss of institutional knowledge and expertise may affect mission achievement.

Figure 9: A Large Percentage of the Postal Workforce Is Nearing Retirement



Source: U.S. Postal Service.

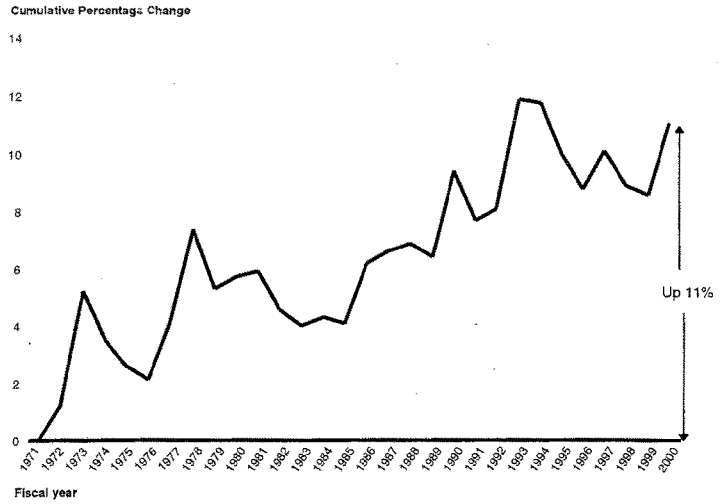
The Service has reported unfunded Civil Service Retirement System retirement liabilities of $32.2 billion at September 30, 2000. These liabilities represent the amount due to the Office of Personnel Management to cover Civil Service Retirement System pay increases and Civil Service Retirement System retirees' cost of living adjustments. The Service also has related future interest payments estimated at $16.5 billion. These liabilities are being paid through annual installments. In fiscal year 2000, the Service paid $3.6 billion toward its liability to the Office of Personnel Management for these Civil Service Retirement System costs. The Service's total annual retirement expenses for both the Civil Service Retirement System and the Federal Employees Retirement System is projected to be $9.1 billion for fiscal year 2001. The Service projects its total retirement expenses will increase annually to $14 billion in fiscal year 2010. These increased payments could reduce the Service's cash flows and place upward pressures on postal rates.

What Actions Has the Service Taken or Planned to Address Its Financial Problems?

We believe that the Service's deteriorating financial situation calls for prompt, aggressive action, particularly in the areas of cutting costs and improving productivity in the near term. The Service has initiated efforts in this regard and has also launched new products and services to increase revenues. However, we believe that it will be difficult for the Service to generate significant revenues from new products and services in the next few years. To the extent that operating costs are not contained or reduced, or revenues are not generated from new products and services, the Service will likely need to continually raise rates to maintain service and to meet its break-even mandate, at least in the short term. However, simply raising rates is not the answer. The Service and the Congress must take actions in order to deal with the systemic problems facing the Service.

Postal productivity—the relationship between the Service's outputs of delivering mail to an expanding delivery network and resources expended in producing them—increased only about 11 percent in the past 3 decades, despite vast changes in automation and information technology (see fig. 10). Although the Service achieved a 2.5 percent increase in its productivity in fiscal year 2000, as the Postal Service and key stakeholders have recognized, sustained long-term increases in its productivity will be essential to controlling costs and thus keeping postage rates affordable. However, numerous reports, including some by us and the Postal Service's Inspector General, have noted inefficiencies in the postal system and difficulties the Service has had in realizing opportunities for savings over the long term.

Figure 10: Postal Service Productivity Growth Since Fiscal Year 1971



Source: U.S. Postal Service.

The Service's ability to improve productivity and control costs is constrained by a number of factors, such as its mandate to provide postal services to all communities. In addition, the Service has had difficulty in achieving the expected savings from implementing new technology. The Service has also reported that extensive work rules and other regulations hamper its flexibility and innovation; and by law, wages and work rules are determined by binding arbitration—a third-party panel—when the Service and its labor unions cannot reach agreement. This process has been criticized as lessening the incentives for both sides to reach agreement. However, no consensus exists on alternatives to this process.

The Service has a self-imposed moratorium on closing post offices. By law, the Service cannot close small post offices solely for operating at a deficit. Further, fiscal year 2001 appropriation legislation restricts the Service from closing small or rural post offices in fiscal year 2001, and this provision has been included in the Service's appropriation legislation for many years. The Service estimated several years ago that about half of all post offices do not generate sufficient revenues to cover their costs. However, the law also provides that the Service in determining whether to close or consolidate post offices must consider the effects on the local community, employees at the post offices, provision of universal service, the resulting savings, and other factors that the Service determines are necessary. Furthermore, the Service has a long, complex, detailed

process for closing post offices in cases such as consolidating multiple post offices in substandard buildings that are located in an area with significant population loss.

Breakthrough Productivity Initiatives

The Service recognizes that it needs aggressive cost management. In March 2000, the Postmaster General called for achieving "breakthrough" productivity savings of $1 billion annually, mainly in mail processing, transportation, and administrative areas. The Service's fiscal year 2001 budget called for saving $550 million through such productivity initiatives and $450 million in additional savings from other cost reduction initiatives. The Service set a goal of increasing its productivity by 0.7 percent for fiscal year 2001 and reports that its productivity increased 1.9 percent for fiscal year 2001 through April 20, which equates to reduced expenses of $775 million. At the same time, given past experience, the Service faces a significant challenge to achieve and sustain large increases in productivity over the long term. Looking ahead, the Deputy Postmaster General announced that the Service is committed to cutting costs by $2.5 billion by 2003. Also, he said that over the next 5 years the Service plans to cut 75,000 work years, reduce administrative costs by 25 percent, and cut transportation costs by 10 percent.

The Service defines breakthrough productivity as a systemic focus on improving productivity by "reducing costs through everything from machine utilization, to standardized processes, to staffing and scheduling, and to resource management." The breakthrough productivity initiatives fall into four key areas: (1) operations, (2) administration, (3) purchasing, and (4) transportation.

- *Operations*: According to the Service, savings in operations will be achieved by implementing best practices on a nationwide basis in areas with the greatest potential for savings, such as using standardized operating procedures and adjusting employees' work schedules to more closely coincide with mail volume. Further savings are to be achieved by accelerating the automation program, which is to reduce the need for manual sorting of mail.
- *Administration*: Administrative positions are to be reduced by centralizing functions, using electronic technology, and eliminating unnecessary administrative transactions. For example, the Service is replacing its outdated time and attendance reporting system with a Web-based application requiring much less time to administer.
- *Purchasing*: The Service plans to cut the cost of purchased goods and services by standardizing purchasing sources and leveraging the Service's size to obtain better prices.
- *Transportation*: The Service reports making across-the-board efforts to reduce the cost of transporting mail at all points in the system, largely by reviewing all mail transportation contracts to identify and eliminate underused and redundant service. These reviews are nearly complete. The Service has reported that it expects considerable savings from moving mail by truck instead of by air due to lower rates.

Other Cost Reduction Programs

In addition to the Service's "breakthrough" productivity initiatives, the Service has announced that it plans to achieve $450 million in savings through other automation initiatives, including the following:

- Upgrading letter-sorting equipment: The Service continues to upgrade this equipment with enhanced optical character reading, barcode sorting, and remote encoding functions.
- Adding and upgrading equipment to sort flat mail such as catalogs and periodicals: New equipment is being deployed to replace some older models and handle additional capacity, and some current models are being equipped with automatic feeders and optical character readers.
- Adding and upgrading material-handling equipment: Robots are being deployed to load mail containers for dispatch, enhancing equipment that transports and stages mail in processing plants, and deploying new technology to dispatch and route mail transported on commercial air carriers.

What Transformational Issues Will Need to Be Addressed?

In addition to the financial and operational issues discussed above, over the past 2 years we have raised concerns about a range of human capital challenges that threaten the Postal Service's ability to continue to provide affordable, high-quality universal postal service on a self-financing basis. We have also discussed the constraints facing the Service, some of which include legal and regulatory requirements, that may impede its ability to carry out its mission. The 30-year-old legal and regulatory system established by the nation's postal laws is increasingly problematic for both the Service and its competitors and is overdue for change. When the Service was created as an independent establishment of the executive branch by the Postal Reorganization Act of 1970, it faced little direct competition. Today, the Service faces growing competition from both private delivery companies and the Internet, and even foreign postal administrations.

In this vastly changed environment, the Service is subject to several statutory and regulatory restrictions that limit its transformational efforts and do not apply to its competitors (e.g., universal postal service requirement, binding arbitration requirement, rate-setting process, and facility closure restrictions). At the same time, the Service has a statutory postal monopoly to deliver letter mail, and also benefits from laws that apply to the Service differently than they apply to its competitors, such as not paying taxes and not being subject to antitrust laws. Congress needs to revisit what statutory and regulatory framework would be appropriate for the Service in the 21st century.

Financial Challenges

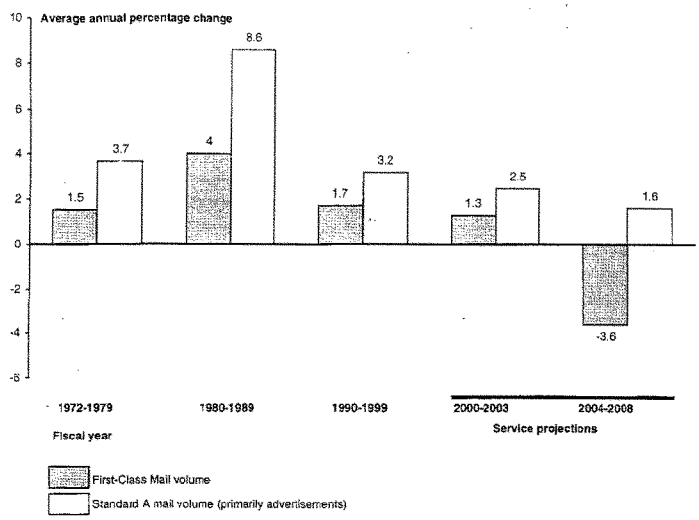
Changes in the marketplace, including greater competition, may lead to increasing financial difficulties for the Service and threaten its ability to provide universal postal service at reasonable rates while remaining self-supporting from postal revenues.

Recently, the Service initiated a study to determine the potential cost savings from reducing mail delivery from 6 to 5 days each week. Can the Postal Service continue to maintain the scope and quality of its retail and delivery services? The answer, at least in the short term, is "yes" – but in the long term, the Service's prospects are uncertain.

Competition is already increasing from private delivery companies and foreign postal administrations accepting outbound international mail from within the United States. For example, United Parcel Service (UPS) is offering a hybrid mail service in which letters are electronically sent to a recently acquired UPS company and then printed and inserted into the U.S. postal system. In addition, at least eight foreign postal administrations now offer services from within the United States to American consumers.

Although it is difficult to predict the timing, magnitude, and potential financial impact of further mail volume diversion to other competitors and to electronic alternatives, according to the Service's latest 5-Year Strategic Plan, longer-term projections suggest that about half of mailed bills and payments will eventually be replaced with electronic billing and payment alternatives. Thus, under the Service's baseline forecast that is included in its 5-Year Strategic Plan, First-Class Mail volume would decline at an average annual rate of 3.6 percent from fiscal years 2004 through 2008 (see fig. 11).

Figure 11: Postal Service Projects Decline in First-Class Mail Volume



Source: U. S. Postal Service.

If First-Class Mail volume declines and the revenue loss is not offset by increasing mail volume in other areas, such as advertising mail or by revenues from new initiatives such as e-commerce, rates would need to rise for any mail categories that take on a larger burden of supporting postal overhead costs. The Service would also face the challenge of responding to any volume declines or changes in the mail mix by attempting to reduce mail processing, personnel, and other costs that have traditionally been considered to vary with changes in the mail volume. However, these costs may be difficult to adjust in the short term. Adding to rate pressure, postal infrastructure costs continue to grow. The Service maintains a delivery and retail network that includes more than 235,000 city and rural delivery routes; more than 38,000 post offices, stations, and branches; and more than 350 major mail processing and distribution facilities. Each year the Service adds new delivery points for new households and businesses—a projected 1.8 million in fiscal year 2001.

Human Capital Challenges

The Postal Service faces additional difficult human capital challenges that must be successfully addressed to maintain organizational effectiveness and improve the workplace environment as well as control workforce costs. These challenges include (1) restructuring the postal workforce of about 900,000 career and non-career employees

and establishing succession planning for impending retirements; and (2) ameliorating the persistent problems in the workplace that have been exacerbated by decades of adversarial labor-management relations and that hinder efforts to improve productivity. The Postal Service's human capital problems can be seen as part of a broader pattern of human capital shortcomings that have contributed to programmatic problems and risks across the federal government.

The Service's Strategic Plan stated that the expected decline in postal workload—in part due to automation and the implementation of information technology—"will inevitably result in both restructuring and a reduction in the workforce." Some of the planned reductions are to be accomplished through eliminating staff vacancies and the work associated with them. These reductions should be done in a carefully planned manner to avoid negatively affecting the workplace environment, operations, and service quality. The Service will be increasingly challenged to deal with human capital issues related to succession planning, maintaining continuity, and the associated cost issues. With a large percentage of the postal workforce nearing retirement eligibility, the Postal Service has the opportunity to realign its workforce and assure that it has the leadership, knowledge, and skills necessary to efficiently and effectively carry out its mission. Given the nature of these issues, the Service will need to include effective participation of its employees in planning and implementing workplace improvements. The Service will also need to maintain the continuity of service to customers as many experienced managers and workers retire and the Service restructures its workforce.

Fundamental improvement is needed in postal labor-management relations. The Service and its major unions and management associations need to resolve long-standing labor-management problems that have hindered improvement efforts, including efforts to cut costs and increase productivity. For example, the Service has made progress in reducing the number of grievances, but at the end of fiscal year 2000, the Service reported about 147,000 pending or appealed grievances. For the Service to be successful, it is critical that it achieves and sustains collaborative working relationships with its labor unions and management associations.

Transformation Questions

If the Postal Service is to transform itself into a modern, efficient, high-performance organization that continues to provide affordable, universal postal service in the 21st century, the starting point is to define and clarify the Service's mission and role over the long term. The Service needs to address questions about its basic mission—that is, the type of postal services that should be provided on a universal basis to meet business and residential customer needs, how these services should be provided, and how they should be financed. Further, questions arise related to what kind of governance and regulatory framework is needed to ensure public accountability. Some of the specific questions that need to be addressed as part of the structural transformation include the following:

- What is the appropriate mission and role of the Postal Service in the 21st century? How should "universal postal service" be defined? How should universal postal

service obligations be provided? Should the postal monopoly be narrowed or ended? Should the Postal Service be allowed to compete in areas served by the private sector and, if so, under what circumstances? To what extent should the Service be subject to the same laws as its competitors?

- Can the Postal Service remain self-supporting under a break-even mandate? If not, what types of financing options should be considered? Should the Service be allowed to make a profit? Should universal postal services be subsidized?

- What changes to the governance and organization structure are needed to realign the organization so that it can successfully achieve its mission? What type of governing board is appropriate? What should be its role? What criteria would be appropriate for selecting board members?

- What should be the related regulatory framework providing oversight in the areas of rate setting, new postal products, and fair competition? How much flexibility should the Service have to change rates? What oversight is needed to protect customers with few or no alternatives to the mail? How should the Postal Rate Commission and other pertinent regulatory authorities exercise oversight with respect to competition and antitrust issues?

- How is the Service to use its employees to accomplish its mission in an efficient, effective, and economic manner? What are the Service's current and future human capital needs? How will the Service ensure that it has the knowledge, skills, and the abilities that are needed? How will the Service make the necessary changes to its workforce, including its size, organization, and deployment?

- What performance management and incentive systems are needed to improve individual and team performance? How can the Service ensure that its managers and supervisors are prepared and trained to provide effective leadership? What labor policies are needed? How can the Service's management and postal unions and management associations develop a shared understanding of the Service's vision; undertake a mutual effort to achieve it; and resolve problems and conflicts over wages, work rules, and individual cases in a fair and effective manner?

- What operational changes are needed to support the Service's mission? How can technology help the Service improve productivity, reduce costs, and enhance customer service?

- Are fundamental changes needed in how the major functional areas are carried out—mail collection, transportation and mail processing, delivery, and retail services? Is the Service's current physical infrastructure aligned to efficiently and effectively support operations? What types of and how many facilities are needed? Should certain existing facilities be consolidated or eliminated? Should certain functions be contracted out or addressed via public/private partnerships?

- What performance and cost information is needed and collected to support Service operations and measure results? What information on projected and actual performance should be periodically reported to the public? How well integrated are the Service's financial, management, and performance reporting systems?

In addition, several issues need to be addressed related to how the Service should be held accountable for results. We have reported that the Postal Service's annual performance plans and its first performance report under the Government Performance and Results Act of 1993 have not been as useful to Congress, postal managers, and customers as they could have been. In our view, the Service's recently published preliminary performance plan for fiscal year 2002 did not fully address the concerns we previously raised about the Service's approach to setting goals and reporting on results. For example, the preliminary plan dropped important goals for net income and for the timely delivery of 2- and 3-day First-Class Mail.

Also, a number of issues have been raised related to the reliability and credibility of the data the Service uses for ratemaking. Timely, accurate, and relevant information will be critical for effective management as well as communications with customers, Congress, and other stakeholders.

Engagement with Postal Stakeholders

Engaging with stakeholders will be an essential part of developing a consensus to address the Service's transformational issues. When the Service begins to engage with its stakeholders to develop a comprehensive transformation plan, it will face a stakeholder community far from consensus on what needs to be done. It would be useful for the Service to develop an approach for engaging with its stakeholders in the development of its comprehensive plan.

In response to the joint request to us from this Committee and Subcommittee, we are working to identify improvement options suggested by various stakeholders and will summarize the results in our subsequent report to you. We have begun this effort and have talked to several stakeholders and plan to continue these discussions. Some of the stakeholders we have talked to so far have included postal unions, mailer groups, competitors, the Service's Office of Inspector General, and Postal Rate Commission officials. They provided a variety of suggestions for action, some within the existing legal framework and others that would require statutory change, as follows:

- *The Service's mission and role*: Representatives of a mailer group and a Service competitor said that the Service's mission should be more clearly defined and raised the issue of whether the Service should be changed to a stock-owned corporation. In the mailer's view, making the Service a corporation with shareholders would hold it accountable and create incentives for success. In the competitor's view, the Service should either be restricted to offering monopoly services that do not compete with the private sector or be held to the same rules as its competitors.

- *Regulation of postal rates*: A mailer group and a union representative favor statutory changes to give the Service more flexibility to set postal rates. For example, a union representative said that the Service should be able to adjust postal rates in response to economic trends. However, Postal Rate Commission officials and a mailer group representative stated that the Service has the flexibility under current law to request alternative rate structures, such as peak-load pricing and phased rate increases.

- *Transparency and accountability*: Postal Rate Commission officials and mailer group representatives recommended that the Service provide more frequent and complete financial and service quality information to the public. For example, they said the Service should regularly disclose the on-time delivery of different classes of mail so that it can be held accountable for the quality of service it provides.

- *Workplace environment*: Several stakeholders stated that better communication is needed among employees, management, and external stakeholders to improve the atmosphere in the workplace and increase productivity. A postal union representative noted that a different management style is needed to encourage employees to give additional discretionary effort. For example, the representative suggested initiating more "bottom-up" communication from employees.

- *Pay and performance incentives*: Some stakeholders noted that greater incentives are needed to maximize productivity and efficiency. For example, a mailer group representative said that management and employees need more effective incentives to further organizational achievement of goals. On the other hand, union officials said that the existing management bonus system encourages managers to take unwarranted action to receive bonuses. Further, a union official noted that city and rural carriers work side by side in some suburban areas under different pay systems, different ways of setting and adjusting the workload, and different incentives for good performance.

- *Flexible staffing*: A mailer group representative favored greater use of flexible staffing procedures to minimize compensation costs, such as using more noncareer workers to handle peak mail volumes. Union officials expressed a different view, favoring the elimination of noncareer jobs to save money.

- *Retail infrastructure:* Mailer group representatives said that the Service should consider, as part of a package of changes, restructuring the retail network by closing post offices and/or relocating retail operations from some post offices to postal retail operations provided in other locations such as retail stores. For example, a mailer group representative suggested a reevaluation of the statutory restrictions on closing post offices, including a reconsideration of the prohibition against closing post offices solely for operating at a deficit. The mailer group representative suggested that the military base-closing model could be used when evaluating the possibility of closing unprofitable post offices.

- *Mail processing network*: Some stakeholders said that the Service could become more productive by using existing automation equipment more efficiently and continuing automation efforts. A mailer group representative advocated that the Service achieve greater standardization of mail processing operations by adopting best practices throughout the system to the maximum extent possible. A representative of an equipment manufacturer said that the Service needed better long-term planning in this area, as well as working more effectively with its major suppliers.

- *Delivery network*: A mailer representative said the Service could save money if some existing residential customers (e.g., customers with mailboxes attached to their homes) were required to use cluster boxes, thus increasing route efficiency.

- *Worksharing discounts*: A union official stated that worksharing discounts—that is, discounts to mailers for mail preparation such as barcoding, presorting, and dropshipping mail—should be greatly reduced or eliminated. In the union official's view, the Service could improve its net revenue by doing the worksharing functions in-house at less cost. In contrast, a mailer group representative said more worksharing incentives are needed for the Service to process mail efficiently, save money, and encourage growth in mail volume. Further, Postal Rate Commission officials said that the Service has the ability under current law to request additional types of worksharing discounts.

- *Productivity initiatives*: A mailer group representative stressed the importance of the Service improving its productivity through cost cutting. For example, he said that the legislatively established rate-setting process provides little incentive for innovation and efficiency since the Service can cover its costs by increasing postal rates. Union officials said that unions and employees could contribute toward developing initiatives to improve the Service's productivity if there was greater prior consultation. At the same time, however, one union official described the Service's current productivity initiatives as harassment of employees.

- *Administrative improvements:* The recent statement of the Service's Inspector General before the House Committee on Government Reform suggested a number of actions the Service could take to improve its performance, accountability, and financial position. One area cited where additional efficiencies could be improved was in the Service's contract management practices. For example, one Inspector General investigation reported that the Service paid over $800,000 for asbestos abatement work that was either over-billed or not performed. The report suggested that the Service needed to strengthen its quality assurance procedures and training of Service contracting officials to ensure accurate contractor billings.

- *New products*: Some stakeholders have said that the Service should have a more business-like approach to its new product initiatives so that the Service would stop spending money on projects that are not generating a positive return.

- *Debt limit*: A mailer group representative and a union official favored raising the statutory debt limit to give the Service the flexibility to borrow instead of raising rates.

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

Contact and Acknowledgments

For further information regarding this testimony, please contact Bernard L. Ungar, Director, Physical Infrastructure Issues, on (202) 512-8387. Individuals making key contributions to this testimony included John H. Anderson Jr., Teresa L. Anderson, Hazel J. Bailey, Gerald P. Barnes, Joshua M. Bartzen, William J. Doherty, Michael J. Fischetti, Jeanette M. Franzel, Kenneth E. John, Roger L. Lively, Albert E. Schmidt, and Charles F. Wicker.

(393021)

Statement of
William J. Henderson
Postmaster General and Chief Executive Officer
United States Postal Service
before the
Governmental Affairs Committee, U.S. Senate

May 15, 2001

Good morning, Mr. Chairman. I want to thank you and the Members of the Committee for your support and encouragement during my three years as Postmaster General. As you know, I am leaving the Postal Service at the end of this month. I appreciate this opportunity to talk with you about where we are in the Postal Service and about the future.

After more than 200 years of history, Americans recognize postal services as their birthright. Americans count on the postal system as a bridge linking everyone, everywhere – from the most rural community to the inner city – with everyone else and to the national economy. The Postal Service is still what it was originally conceived to be, a universal connection that "binds the nation together" as one.

The logistics of the system providing this unique coverage are enormous. Think about a mailstream successfully delivering 668 million pieces per day, interconnecting 130 million addresses throughout America in all possible combinations. Our services now have to generate over $68 billion in revenue in a year to cover costs. This includes the nation's second largest payroll, which supports some eight hundred thousand families in communities all across the country.

These hard-working employees provide excellent service in my opinion. Steady improvement over the last seven years has brought on-time performance numbers for overnight local delivery of First-Class Mail from the low 80s to consistently 93 percent or better. Today even the most congested metropolitan areas regularly surpass what the best performers anywhere were able to achieve when this measurement first started. Our pay for performance initiative for 70,000 postmasters, supervisors, professional and technical employees and managers, deserves much of the credit for driving this and other improvements.

With a lot of help from our customers, management has made progress in driving costs out of the system. Letter mail automation alone provided almost $3 billion in cost avoidance last year, and a cumulative $19 billion in cost avoidance since 1987. That makes a huge difference in the postage rates today. In fiscal year 2000, control of resources compared to workload gave us a Total Factor Productivity improvement of 2.5 percent, equivalent to $1.6 billion in expense reductions. This was our best productivity improvement since 1993.

One way to look at all of this is that the current system has worked remarkably well so far, is deeply rooted, and will be very difficult to change in a fundamental way. But on closer look, fundamental change is precisely what will have to occur, one way or another.

The basic reason is that the whole environment in which postal services are needed and used in our economy is already changing dramatically. Technology is driving the productivity of the economy and revolutionizing the pace at which markets evolve and business must adapt. At a practical level,

boundaries between the mail and other services are crumbling. The mailstream is shifting in the direction of lower-margin products. Like other businesses, foreign posts are taking a more global perspective, and are becoming more active participants in the U.S. market.

These changes can bring opportunities for the Postal Service, but only if we are prepared for them. Currently, the 30-year-old model under which we operate is not sufficient for the Postal Service to be the agile player America needs it to be in today's marketplace. If we find ourselves lagging behind what many of our customers require from us to do business, then they will pursue other opportunities. Those who genuinely have no good alternative to the Postal Service will find our services less affordable.

The recent downturn in the economy provides a lesson in what our industry could look like in a downward spiral. As postal revenues grow soft, costs are relatively less flexible, and our finances suffer. In a technology-driven economy, a carrier delivery service is disproportionately labor-intensive; there is no way around that. At the same time, universal service requires us to expand capacity to serve an ever growing number of routes and customers. A system with fixed responsibilities to serve an expanding population needs to grow volume and revenue in order to keep its prices affordable. We need the opportunity to keep up with our markets or else the cost of universal service will get steeper.

The current ratemaking system can be compared to a crystal ball-gazing exercise, starting a couple of years in advance of the actual event. It should be

no surprise that the predictions of even the best experts can sometimes go wrong. Far from anticipating a slowing economy, or the resultant sluggishness in postal revenues, the Postal Rate Commission in its November 13, 2000, recommended decision, stated that:

> "Beginning with the economic climate in which the Postal Service operates, the short-term outlook for the national economy does not appear to involve any significant risk of unforeseeable financial harm to the Service."[1]

The Postal Service's witnesses, who expressed concern about the future course of the economy, turned out to be closer to the target. But even with the modified rates just approved by the Governors based on that testimony and the remainder of the record in that case, revenues are still in danger of falling short of costs this year by 2 billion dollars. Another way to put that is, our prices are still quite a bit lower than they would have been – lower than current law would have required them to be – if everyone involved in the last rate case could have had perfect vision.

In a break-even, labor-intensive, universal service model, what can be done when revenues are falling short of costs? With service and network requirements still growing, not shrinking, and with an outside arbitrator imposing the price of labor, some other things like capital can be cut temporarily, as the Postal Service has done. The troublesome question is, how long could the Postal Service go on in this way – resolving revenue shortfalls by increasing

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[1] Opinion and Recommended Decision, Postal Rate and Fee Changes, 2000, Postal Rate Commission Docket No. R2000-1, 70 (November 13, 2000).

rates and postponing needed investments in assets – without eroding universal service and the core of its business?

Experience is already showing that the future of posts around the world is not in the old, static, regulated and protected model, but in the commercial sector. Monopolies have less impact when technology and other business forces make nominally protected services more and more vulnerable to potential diversion. For bills and statements, which have always been at the heart of the postal monopoly, the issue has become not what the law says, but how quickly business can figure out solutions giving customers enough reason to leave the mail system. For now, the good news for postal systems is that resistance is still strong. But the underlying economics say significant diversion will happen. The questions are when and how fast.

Advances in electronic communications do not negate the need for a Postal Service or for universal service. The dot-com experience has demonstrated that the ability to get product to the customer is the key on-line, just as it is for mail order. The digital economy must connect with the traditional one. And the Postal Service is the last mile. Yes, some others provide excellent service. But they do not touch the neighborhoods and rural communities in the way we touch them all.

Fortunately, there is still time to make changes while America's postal services are strong. It will require vision, and will not be easy. The solution, in my opinion, is to put trust in market forces to shape the postal services that will serve America best in this century. This is where the other posts are going, and

it is where the United States will need to go as well. Understandably, it is hard for the country to let go to this extent, after the long tradition of defining what we want from the postal system quite tightly, in legislation and through regulation, and while a working Postal Service is still in place.

Some might want to wait until the need for reform becomes more painfully obvious later on, as the public sours on deteriorating service at less affordable prices. But if the economy is forced to learn how to work around postal services in the meantime, instead of working with them, then a well-performing, competitive postal system could be difficult to retrieve. The marketplace is unforgiving of weak or late attempts to provide what the customer needs now.

I believe that America wants and needs a strong, healthy Postal Service that will continue to provide universal, affordable service throughout the nation. The best hope for that outcome is a structural reform updating the system to meet the challenges of the dynamic world in which we live today. The Postal Service will be pleased to assist in this task in any way we can.

Thank you very much, Mr. Chairman. I will be glad to respond to any questions.

Statement of
Robert F. Rider
Chairman
Board Of Governors
United States Postal Service
before the
Committee on Governmental Affairs, U.S. Senate

May 15, 2001

Good morning, Mr. Chairman and members of the Committee. I am Bob Rider, Chairman of the Postal Service Board of Governors. I appreciate this opportunity to discuss the challenge facing universal mail service and the necessity for legislative reform.

The mission entrusted to the Postal Service by Congress is to provide universal mail service to every address in all communities and neighborhoods throughout the United States, at affordable rates. This mission of inclusion and facilitation for the nation's business and personal life is as fresh and relevant today as in the country's beginnings. The American people have always enjoyed among the lowest rates and best service in the world.

Throughout its history, the Postal Service has grown with the nation. We still add over 30,000 new addresses each week to the distribution and delivery network, while keeping average price increases below the rate of inflation. This is the equivalent of a brand new city of Chicago every year. We have had only two rate filings since 1995, both times just a penny on the First-Class rate. We have done this by restraining costs and improving productivity as service networks expand to handle the nation's growth.

In recent months, several forces have combined to upset the balance between revenue and cost for this year:

- Postal revenue growth has slowed with the weak economy (accounting for a expected shortfall between $500 million - $1.5 billion);
- The Postal Rate Commission recommended rates lower than those the Postal Service had proposed and our financial plan assumed (increasing the net loss by $800 million); and
- Other costs, such as fuel, have grown due to rising prices (adding about $150 million this fiscal year).

Taking these factors in combination, we currently believe the Fiscal Year 2001 net loss could exceed $2 billion.

The law provides us a limited opportunity to deal with the shortfall. As finances have suffered, the Board has attacked the problem with the tools now available to us. Earlier this month, the Governors reluctantly decided that we must exercise our authority on the record of the most recent rate case to modify postage rates to address a shortfall of about $1 billion, through a rate adjustment averaging 1.6 percent. We took this action to protect the financial integrity of the universal mail system. Because the adjustment comes so late in the fiscal year, this move yields only about $200 million of the shortfall in the remainder of this fiscal year.

In recent years the Postal Service has had good success with programs for managing workhours and other controllable cost elements. Last year's productivity improvement of 2.5 percent was the best since 1993. In current

circumstances, however, extraordinary, and unfortunately painful, additional measures are essential:

- We have eliminated $1 billion from the capital commitment budget for this fiscal year, in order to conserve the cash to pay our bills, and to reduce future commitments to match cash flow.
- We have directed management to prepare another rate filing, to get the Postal Service back on a pay-as-you-go footing, maintain financial viability, and achieve break-even as the law mandates.
- We directed management to take a fresh look at all operating expenses to realize additional savings. A number of actions are now in place. Among these are:
  - ✓ a hiring freeze at headquarters. Management has eliminated over 1,100 headquarters and headquarters-related positions since the beginning of the fiscal year, along with 20 percent or 232 of the positions in the area offices. These reductions are continuing at headquarters, area, and district offices.
  - ✓ a nationwide freeze in hiring of processing and distribution clerks. So far we have over 7,000 fewer career clerks on the rolls than at the end of the last fiscal year.
  - ✓ a series of comprehensive Area Mail Processing studies, which will identify opportunities to consolidate operations and reduce expense.

Many of the delayed capital projects are badly needed. Their postponement will make it difficult to meet the needs of our customers and our employees. The Board's responsibilities, nevertheless, require us to make sure that financial resources are on hand to pay bills when they come due. Every two weeks these bills include one of the nation's largest payrolls, providing the livelihood of more than 800,000 postal families.

In the years ahead, cost cutting and rate increases within our current statutory framework are not sufficient for the Postal Service to keep pace with today's market dynamics. More businesslike management is required to maintain the financial integrity of the Postal Service and the foundation for universal mail service.

The outdated statutory framework both contributes to current financial problems and severely limits what can be done about them. The Postal Service has limited authority over its prices, services, wages, and the other management levers in the postal system. The cumbersome history of the recent rate case – which took almost two years to complete from preparation to finish, spanning periods of both economic boom and slowdown – illustrates part of the problem.

None of the private firms whose services compete with, or substitute for, the mail go to every household every day. The Postal Service delivers to 113 million addresses six days a week. To break even, we need an average of about $2.00 in postage for each delivery point every day. But except in the more affluent neighborhoods, many households do not receive that much mail. If

universal service does not remain economically viable, many Americans will not get the level of service or the affordable prices they are accustomed to receive.

The most advanced nations around the world are rapidly modernizing and reorienting their postal systems. The Postal Service delivers 40 percent of the world's mail, but America lags far behind in postal reform. The overseas posts are reorganizing to protect their universal service and keep their rates affordable. Many now come over here to compete for some of our mail. Without vigorous postal reform in the United States, this country faces increasing pressure on the economic foundation for universal service at affordable prices.

The American people should not have to face this result. The United States should continue to have the best, most modern postal structures and services in the world. We pledge that the Postal Service will do all that we can, both to manage the current challenge, and to contribute to the success of a comprehensive postal reform measure.

Thank you. We will be pleased to respond to questions.

United States Senate
Committee on Governmental Affairs

Testimony of Commissioner George A. Omas
Vice Chairman, Postal Rate Commission

May 15, 2001

Thank you Mr. Chairman.

My name is George Omas. With me today are my fellow Commissioners, Danny Covington, Ruth Goldway, and Trey Le Blanc. As you know, the position of Chairman of the Postal Rate Commission is currently vacant. I was elected Vice Chairman by my colleagues, and have been performing the administrative functions of the Chairman since February.

This morning I will focus my remarks on three topics. First, the Postal Rate Commission recently concluded Docket No. R2000-1, the most recent omnibus rate case. I will review that case and discuss several ways in which our experience in that case is relevant to postal issues under discussion before Congress. All of us are very concerned with the recent rapid deterioration of Postal Service finances. I will attempt to provide the Commission's perspective on recent Postal Service operating results as my second topic. Finally, I will offer some suggestions intended to alleviate the causes of the current crisis atmosphere.

In early March of this year, the Postal Service Governors addressed letters to the President and Congressional Leaders indicating that a comprehensive review and overhaul of the nation's postal laws was necessary. They focused on two particular aspects of the current law, the process established for developing postal rates, and the "collective bargaining followed by compulsory arbitration" system for establishing wages.

I will address only the first of those issues—how postal rates are set. I have been involved in reviewing postal issues since the 1970s, and I have served as a member of the Postal Rate Commission while the two most recent omnibus rate cases, R97-1 and R2000-1, were under consideration. During my time on the Commission I have seen ample evidence of why an independent review of the rate and classification changes that the Postal Service might seek to impose upon the mailing public is essential.

The Existing Ratemaking Process

The Postal Service is a vast network that is woven into the fabric of American business and personal relationships. A reliable, efficient Postal Service is one of the bedrock strengths of the American economy. It is appropriate for Congress to investigate when the Postal Service Governors issue a call for a comprehensive review of existing law, and suggest that absent major improvements, the system the American people have come to know and trust may be at risk. I would suggest to you, however, that the current ratemaking system achieves an effective balancing of the needs and interests of the many segments of our society most affected by postal rates.

In fact, I think a dispassionate observer might easily conclude that the ratemaking system established by the Postal Reorganization Act, as amended in 1976, has been a singular success. That Act enunciated three primary rate policies. First, rates were to be high enough to enable the Postal Service to break even. Second, rates for each subclass and service were to be high enough to recover the direct costs of providing service to that mail. Third, rates were to be fair and equitable. Each of these goals has been met.

In the 30 years since reorganization the Postal Service has collected some $976 billion of revenue. Over that time, the Service has experienced a net loss of only $4.3

billion, or to put it another way, revenues have recovered 99.6 percent of costs. The Postal Service essentially has broken even since reorganization.

The Commission and the Postal Service have also adhered to the policy that the revenue from rates for each type of mail should recover its costs. Extensive work has been done to identify what categories of mail cause various types of postal costs, and the costs attributed to each subclass and service serves as its rate floor. Both mail users and private firms that compete with the Postal Service for delivery of products not subject to the postal monopoly understand that this statutory prohibition against cross subsidy is rigorously enforced through the Commission's independent review of the Postal Service's rate proposals.

I would also point out that twice in the past ten years Congress has seen fit to enact minor amendments to the Postal Reorganization Act to fine tune the formula for developing rates for mail sent by qualifying non-profit organizations. This provides an example of the benefit of having a national Postal Service. Congress is able to review the impact of postal rates on various segments of society and make adjustments deemed consistent with public policy.

The final goal, that postal rates be fair and equitable, is obviously somewhat subjective, and no one individual can provide a definitive evaluation of how well that standard has been met. Nonetheless, review of the Postal Service's rate and classification proposals by an independent agency with no stake in the outcome is the most likely way that I can think of to assure that Congressional policies are faithfully carried out.

The Act details numerous public policies, including nine factors specifically applicable to developing postal rates. Rates are set in an open, public proceeding during which all interested segments of society have the opportunity to show how those policies relate to specific types of mail, to present evidence verifying their concerns, and

to test the validity of arguments presented by other stakeholders. Then the Commission must fully explain, in writing, the basis for each of its decisions. Its decisions must be based on the public, evidentiary record, and appellate review of its written decisions is available to all parties, including the Postal Service.

Recent Rate Case Experience

Over the years, an extensive cross-section of American businesses have seen fit to present their views before the Postal Rate Commission. Small businesses as well as high volume mailers benefit from the existence of an independent agency that reviews Postal Service proposals. For example, in my first case on the Commission, a group of small business shippers found themselves faced with a 220 percent increase in the Special Handling fee. The Commission asked the Postal Service to provide support for its proposal, and the Service was unable to do so. As a result, the proposed increase was not recommended.

That case also was notable because the Postal Service proposed to increase rates even while it was generating substantial profits. Some mailers contended that the Commission should have rejected the Postal Service request outright. Instead, the Commission recognized both the profits from recent positive Postal Service operating results and the added costs of newly planned computer upgrades, and scaled back the proposed increases to be consistent with the evidentiary record. Additionally, the Commission urged the Board of Governors to defer implementation of the new, higher rates until the Service actually needed an infusion of additional cash. The Board delayed implementation of the higher rates approximately six months.

The most recent omnibus rate case, Docket No. R2000-1, was just completed. Our decision in that case has become quite controversial because of unanticipated events that occurred after the case was all but over. The Governors asked the Commission to reconsider its decision twice, and just a week ago the Governors

announced that they found it necessary to modify the Commission's decision to generate additional revenues.

Some may suggest that this outcome provides an indication that a fundamental change in the ratesetting process is necessary. I would suggest just the opposite. In many ways, this case has provided an example of why open, public proceedings are beneficial when establishing rates for an essential monopoly service.

The Postal Service submitted a request for a Commission decision in January, 2000. That request was accompanied by a full explanation of why the Service believed rate increases were necessary, and separate justifications to support its proposed increases for each of the classes of mail. Seventy intervenors appeared in this case, many of which were industrywide associations representing hundreds of mailers.

The intervenors were able to examine the justifications offered in support of the requested rate increases and to present facts and arguments supporting different results. Many intervenors took advantage of Commission rules to submit testimony and arguments jointly.

Mailers are not the only interests to intervene before the Commission. Private businesses that compete against the Postal Service also are allowed to present evidence to the Commission. Everyone is aware that parcel delivery firms such as United Parcel Service are active before the Commission, but other industries that are not so financially robust, such as door-to-door delivery firms, also take advantage of the opportunity to appear before the Commission if they believe proposed rate changes are unreasonable or anti-competitive.

Businesses that depend on the Postal Service also have the opportunity to be heard. For example, in Docket No. R2000-1 firms that had developed electronic postage systems and greeting card manufacturers presented evidence. Other

intervening interests were represented by labor unions, individual citizens, and potential suppliers. Finally, the law provides for an independent representative of the interests of the general public, a function performed by the Commission's Office of the Consumer Advocate.

All of these groups may focus on different aspects of the evidence offered by the Postal Service as justification for its rate proposals. Taken together, they present the totality of the complex interrelating interests that effect the Postal Service. Participants frequently suggest new approaches to rate or classification issues, and their ideas often influence final Commission recommendations. On occasion, an intervenor will focus on an issue that had been completely overlooked by postal management, such as the example from Docket No. R97-1 that I mentioned.

It would be a mistake to assume that mailers that use the same class of mail have identical interests. On occasion, large circulation publications and small circulation publications have had directly contrary interests. Similarly, high density advertising mailers and targeted advertising mailers often have completely different concerns. Shippers of heavy parcels and light parcels also may offer conflicting testimony. The Commission's role is to sort out the merits of these conflicting claims in an open public proceeding.

I have emphasized the benefit of an open public forum several times. Let me give you an actual example of why process can be so important. When the Commission first began to evaluate the evidence provided in support of the Postal Service's request it focused on the rapidly increasing costs of processing the flat-shaped mail often sent by periodical publications and advertising mailers. The Commission's early analysis showed that since 1993, the costs for processing flats had been increasing well above the cost of inflation, even as new automated equipment for handling this mail was being added.

The Commission directed the Postal Service to review this problem and present testimony from knowledgeable witnesses who could explain the causes of this phenomenon. The Postal Service provided testimony by two witnesses; however, these individuals could not explain why flats processing costs were skyrocketing.

A coalition of intervenors concerned with the impact of out of control flats processing costs on rates presented evidence on numerous steps that the Postal Service could take to rein in flats processing costs. This testimony referred to analyses done by a joint Industry-Postal Service task force. The Postal Service had not incorporated in its rate request any of the potential savings identified by the task force.

Faced with a public record describing costs rapidly escalating for unknown reasons, and numerous potential opportunities for achieving savings, the Postal Service determined to implement several of the suggestions developed by the task force. As a result it was able to adjust its projections of future expenses, and support substantially smaller rate increases for flats mailers than it had initially requested.

From my vantage point on the Commission, it seemed clear that the Postal Service would have demanded the large increases it initially proposed had it not been for the public focus on its poor record for restraining flats processing costs. It also seems clear to me that the expertise developed by the Commission over time allowed the early identification of the magnitude of the problem with escalating flats processing costs.

The most controversial aspect of the Commission's decision in Docket No. R2000-1 was its determination that the Postal Service had failed to justify its request for $1.7 billion for unidentified "contingency" expenses.

Let me put that request in the context that it was presented to the Commission. The Service analyzed all of its expected operating and non-operating costs for fiscal year 2001, and determined that it needed to raise rates. In total, the Postal Service

asked for rate changes to generate an additional $2.8 billion. Of that amount, slightly over $1 billion was to cover estimated cost increases in 2001. The remainder, $1.7 billion, or 60 percent, was requested as a contingency fund to cover potential misestimates and unforeseeable events.

Never before had the Postal Service asked for a rate increase that was intended primarily to generate funds for contingencies. By definition, the contingency fund is intended to provide insurance against unexpected adversities that are completely speculative. It is to cushion against misestimates and unforeseeable events. Such events are just as likely to help the Postal Service as to hurt it.

Not surprisingly, a number of mailers vehemently objected to the Postal Service's request to raise rates to provide so much money to guard against the potential for a negative unforeseeable event. In fact, 25 participants sponsored testimony that was sharply critical of increasing rates to provide for such a large provision for contingencies. They pointed out that while the Postal Service had presented voluminous evidence in support of its request for rate increases, only three pages of testimony was offered in support of the need for a $1.7 billion contingency fund. The evidence presented by mailers' representatives also pointed out that the limited Postal Service testimony was focused almost entirely on the potential for misestimates. The chief "unforeseeable" event identified by the Service was the potential for adverse legislation, and it did not present any analysis of the frequency and impact of unforeseen events that had occurred over the past thirty years.

Mailer witnesses pointed out that after thirty years of projecting costs in support of rate increases, the Postal Service had become far more proficient at predicting the impact of cost change factors on its operating expenses. They contended that over this time the Service also should have gained experience that would enable it to predict how frequently unforeseeable events would be likely to affect the Service's bottom line, and how large a provision for contingencies was needed to protect against such events.

Some of these witnesses contended that in the absence of probative evidence, the Commission should reject the entire portion of Postal Service request for rate increases that was to fund the provision for contingencies.

The Commission found that the evidence before it did not support a $1.7 billion provision for contingencies. The Commission was persuaded that an analysis of the frequency and impact of unforeseeable events was feasible by testimony that cited the practices of regulated insurance companies that must perform this type of analysis on a continuing basis.

The Commission criticized the Service for failing to analyze its past experience and develop some justification for its contingency request. However, the Commission refused to disallow the Service's entire contingency fund request. The Commission recognized that in the previous case, Docket No. R97-1, it had allowed one percent of the Service's projected annual expenses as an appropriate contingency fund. Additionally, it noted that the Postal Service had indicated that certain projected cost savings were somewhat speculative. Therefore, the Commission allowed a fund for contingencies equal to 1 ½ percent of projected total annual expenses, or slightly more than $1 billion.

Last week the Governors modified the Commission's recommended rates. They announced that they would implement new higher rates. I will not attempt to critique that Decision. I will, however, highlight a few points that I view as particularly pertinent to the subject of today's hearings.

The Governors justify their action by arguing that the Commission exceeded its authority when it determined that the Postal Service failed to justify its proposed $1.7 billion contingency fund. They recognize that in this case intervenors argued, and the Commission found, that the Postal Service had failed entirely to explain a rational basis for selecting its proposed 2 ½ percent contingency. But they contend that the size of

the contingency is unreviewable so long as one or more reasons why some contingency might be necessary have been identified, and some attempt to explain the Service's proposal has been offered. They also gloss over the Commission's finding that a contingent field reserve can not be allocated among mailers as a recognizable expense.

The Governors and the Commission disagree about one aspect of the current law. I think it is fair to say that the Governors believe that it is their responsibility to establish how much revenue the Postal Service will need, and that rates should be set high enough to provide whatever revenue the Governors think they might need. The Commission believes that mailers, particularly captive mailers of monopoly products, should not have to pay higher rates unless the Postal Service shows that its request for additional revenue is reasonable.

I do not know whether this conflict will be the subject of a judicial challenge to the Governors' recent action. Regardless of what a court may or may not decide, I sincerely hope that in future cases the Postal Service will not request revenues without providing adequate supporting justification. Mailers have a right to know why their rates are being increased.

There is another aspect of Docket No. R2000-1 that bears special mention. When the Postal Service filed its Request, its cost estimates were based on historical costs incurred before more recent rates and classifications were put into effect. For this reason, its cost estimates were questionable. Therefore, after obtaining comments from all participants, the Commission instructed the Postal Service to update its request to reflect its most recent year of actual cost data. At the same time, the Commission invited the Postal Service to revise any of its projections of costs, volumes, and revenues to reflect its most recent intelligence.

The Postal Service presented updated cost data in July, 2000, and its witnesses supported these changes during hearings in August, 2000. Let me interject at this point

that this was a major project for the Postal Service, and the Commission commends the Service for their effort and cooperation.

The Commission used this updated cost data in the R2000-1 decision. The more recent cost data improved the Commission's expense projections and resulted in recommended rates that more accurately reflected Postal Service operating experience. Initially, the Postal Service opposed use of updated cost data. Nonetheless, the Postal Service provided new estimates for many cost items in its July submission.

For example, the Service predicted $192 million of additional annual expenses as a result of changes in the cost of living index.

It increased its estimates of annual transportation costs by $49 million to reflect the increases in fuel costs that occurred in the Spring of 2000.

The Service even anticipated that the labor contracts it would conclude during fiscal year 2001 would be more expensive than it had estimated when it submitted its original filing, and it asked for $261 million to cover these additional projected expenses.

It also predicted that new productivity programs would reduce costs in certain areas, and it identified potential new sources of revenue. However, in total, the July 2000 revisions, after corrections and supplementary explanations, increased the Postal Service's projected revenue needs by $587 million. The Commission recommended rates sufficient to cover all of these adjusted cost projections, although a new contingent field reserve was not separately funded, but was treated as justifying a larger contingency allowance than otherwise would have been approved.

Postal Service witnesses presented their final financial testimony on August 31, 2000. At that time the Postal Service was predicting that it would lose $325 million in fiscal year 2000. The evidentiary record before the Commission was closed in early September, participants submitted briefs and reply briefs analyzing the record, and the Commission's decision was issued in early November, 2000. Also in early November, the Postal Service announced that its loss for fiscal 2000 was only $199 million, a better result than it forecast just two months before.

Postal Service Post-rate Case Projections

At the same time that the Service announced that its fiscal 2000 loss was smaller than it had predicted on the R2000-1 record, the Postal Service suddenly began to trumpet the possibility of huge deficits for fiscal year 2001. The Postal Service referenced these expected deficits in supporting the Governors' request for reconsideration. These potential deficits, however, were never mentioned in the evidence presented to the Commission.

When the Commission received the Governors' requests for reconsideration, it invited the Postal Service to update the record with evidence explaining its new, more pessimistic estimates. Such evidence could have supported adjusted rate recommendations. However, the Postal Service expressly declined to present any evidence explaining its new, post hearing financial projections.

The letter inviting me to testify here today asked whether I concur with the Postal Service's projection of a $2 to $3 billion deficit. The short answer is that I cannot evaluate that estimate.

Initially, it was hypothesized that the projected deficit resulted from volume declines caused by the growth of electronic communications. But volumes were not declining. Then it was suggested that the mix of mail had changed, and that the Service is now delivering less expensive mail. But from the data currently available to the Commission, it appears that the major causes of current operating losses are expenses that are much higher than the Postal Service expected.

The Postal Service has not provided any systematic explanation of its multi-billion dollar loss projections. In fact, a major part of its estimate is a potential $1 billion loss that is never associated with any cost or revenue category. This $1 billion can best

be characterized as a potential loss "if whatever is going wrong continues to get worse." This is not analysis.

The imprecision of these forecasts makes it impossible to evaluate their reliability. The Postal Service may have detailed analyses that justify at least some portion of these forecasts. I hope so. It would be embarrassing to think that the management of a $70 billion organization had no clue about **why** it was suddenly incurring far higher costs than it forecast to the Commission. But any analyses the Postal Service may have prepared, have not been made public.

The Postal Rate Commission's primary function is to respond to Postal Service requests for rate and classification decisions. When the Postal Service asks the Commission to recommend rates, it provides detailed cost data to support its request. After the Commission provides its recommendations, it does not have access to data that would enable it to know where postal costs are diverging from projections, or whether the Postal Service is implementing its promised cost savings programs. At this point, the Commission cannot determine with any precision what portions of the Postal Service's rate case cost projections were misestimated. Therefore, the Commission cannot evaluate whether the Service is taking effective steps to halt its growing deficit.

The Commission has examined the limited, preliminary cost reports released by the Postal Service. We have annualized the results of the first six accounting periods of 2001 data published by the Postal Service and compared those figures with the annual expense projections estimated for fiscal year 2001 in the R2000-1 case. This comparison is quite revealing.

Comparing just seven important cost elements, the Commission finds that if current cost patterns continue, the Postal Service is likely to incur $1.8 billion more costs in 2001 than it estimated to the Commission in July, 2000. To me this result undermines many of the arguments suggesting that radical reform of the price setting mechanism is necessary.

- ⇨ Skyrocketing costs are not the result of volume losses to electronic messaging.
- ⇨ Skyrocketing costs are not the result of mailers doing more worksharing or switching to less expensive postal products.
- ⇨ Skyrocketing costs are not the result of a failure to rapidly bring new products to the marketplace.

The table below shows the seven cost elements, and how inaccurate the Postal Service's cost projections may have been. One interesting area is that expenses for clerks and mailhandlers are running below projected levels. Hopefully, this reflects cost savings resulting from additional mailer worksharing. But it might indicate that work formerly performed by clerks is now being done by carriers. As I said, we do not have sufficient information to evaluate these possibilities.

Decrease in Net Income Due to Expense Increases

Summary of Largest Cost Differences
Current Annualized Estimate vs. R2000-1 PRC Estimate

	FY 2001 Estimate ($ Millions)		
	Current *	R2000-1**	Difference
City Carriers	14,142	13,580	562
Rural Carriers	4,637	4,095	542
Clerks & Mailhandlers	19,024	19,396	(372)
Workers Compensation	1,025	855	170
Purchased Transportation	5,231	4,649	582
Vehicle Maintenance	480	338	142
Long-Term Debt Interest	382	252	130
Total Difference			1,755

* Annualized costs based on six (6) accounting periods of data
** Estimates submitted July 7, 2000

Matching Problems with Solutions

The two questions that need attention are these:

- What can be done to fix the problem of rapid, unexpected increases in postal costs?
- What can be done to prevent that problem from reoccurring?

I think the other witnesses on this panel are giving a great deal of attention to fixing the problem of unexpected cost increases, and I am sure that they will find solutions. I do have some thoughts on how to prevent the problem from reoccurring.

I mentioned earlier that during the R2000-1 rate case the Commission identified a continuing negative trend in the costs of processing flat shaped mail. The Commission was both surprised and dismayed that the Postal Service had not recognized that trend and taken corrective action more promptly.

The Commission came across a similar problem with regard to the costs for processing media mail. Media mail is the new name for parcels sent by book and record clubs, among other things. Toward the end of our proceeding it became apparent that media mail was also experiencing a continuing negative trend in processing costs. The Commission asked the Postal Service to provide a witness to answer questions on the potential causes of this trend, and again, it appeared that the Postal Service had not been aware of the trend, and had not begun to take corrective action.

These two situations lead me to suggest that the Postal Service, and the whole mailing community, would benefit if the Commission was tasked with the function of performing an annual performance review of postal operations, and reporting its findings to the Congress to assist it in its oversight responsibilities. I am not suggesting yet another audit of Postal Service data systems. I suggest that the Commission provide an independent review of operating results, and evaluate operating trends, including the success of new processing, transportation, and delivery initiatives. The Commission could identify areas where cost results were unexpected, and could focus attention on potential problem areas. As a natural complement of this effort, the Commission could review how well the Postal Service is meeting its service commitments, not just to overnight First Class mail, but to all classes of mail.

The recent slowing of economic growth in this country might explain sluggish growth in postal revenues. To this point, I have seen nothing that explains the rapid increase in Postal Service operating costs. Having a separate, independent agency with postal expertise regularly reviewing the Postal Service's performance results should provide Congress, mailers, and the Postal Service itself with an early warning system to identify negative trends before those trends get out of hand. Furthermore, a continuing public report would provide a sound foundation for evaluating proposals for major structural change.

It is almost a truism that one needs to know what the problem is, before one can develop an effective solution. Informative annual performance reviews would help all interested segments of the postal community to understand what problems are most pressing, and it would provide a factual basis for cooperative efforts to fashion remedies.

Another benefit of an annual performance report would be that it could be part of an integrated program that would lead to more effective, and perhaps less time consuming, rate cases. Participants in rate cases could use the annual reports as a reference. Additionally, the development of an annual report would require regular, timely data submissions from the Postal Service. I am not suggesting new data collection systems. I envision the Postal Service making already collected data available on a more regular, periodic basis so that trends could be more quickly identified and analyzed. Having this data available in advance of a rate filing should reduce the time intervenors need to develop their evidence.

One of the main reasons that rate cases take ten months is that the Postal Service frequently withholds its most recent operating data compilations from the public during the final stages of rate case preparation. Thus, the Commission and interested participants must start from ground zero to analyze the materials the Postal Service

provides in support of its rate requests. Often these materials reflect new, unexplained cost allocation procedures. Furthermore, because certain types of relevant data are not available on a quarterly basis, it is quite difficult to identify trends quickly, without wading through the large amount of data the Postal Service files with its requests. I understand that it takes resources to prepare final versions of relevant data reports; however, by failing to use its resources to provide these data the Postal Service allows its critics to speculate that the Service withholds this information from the public as a litigating strategy, to make it more difficult for the public to participate economically in rate cases.

We have all heard that the Postal Service is considering whether to file a rate case this July. The Commission and mailers would be able to respond far more quickly and effectively to such a filing if the Service had already published its fiscal 2000 Cost and Revenue Analysis Report, its Cost Segments and Components Report, and the breakout of billing determinant data.

I am aware that certain critics have suggested that the postal ratemaking process is too lengthy and too inflexible. The current process for setting postal rates is not without flaws. I suggest, however, that part of the Postal Service's frustration with the system is the result of its failure to take advantage of currently available options.

While the Postal Service might prefer a system that would allow it to change rates unilaterally following notice in the *Federal Register*, absolving the Service from having to justify rate increases would remove a major incentive for the Service to operate efficiently. Furthermore, over the last thirty years the Postal Service has consistently sought to increase the share of institutional costs imposed on captive monopoly users. If freed from the discipline of formal rate cases, the Service might shift an ever increasing share of total costs onto captive users.

In recent rate cases the Commission has allowed itself barely six weeks to evaluate the participants' arguments and develop its recommendations. The vast majority of a ten-month rate case is allotted to giving participants the opportunity to understand and challenge the justifications for rate increases presented by the Postal Service. Parties have repeatedly told the Commission that they had barely enough time to participate effectively.

Nonetheless, I believe that opportunities exist for the Postal Service to expedite the process. Recently, the Service has estimated that it takes six months to prepare a case for filing with the Commission. This apparently assumes that each case must be started from scratch. I cannot understand why management does not have the outlines of a pro forma case available at all times.

The Postal Service should have been able to request rate relief as soon as it began to believe that it would incur significant losses in fiscal 2001. The Commission invited the Service to use portions of the record made in Docket No. R2000-1 to support a prompt request for any necessary emergency relief. The Service's preference for developing an entirely new Request was a matter of choice, not an obligation imposed by the statute.

Under current law the Postal Service has almost unlimited discretion to develop rate change proposals. The current statute is very clear that only the Postal Service may initiate rate changes. The Postal Service may request large increases or small ones; simultaneous increases for all classes or targeted rate changes for individual subclasses; experimental rates of fixed duration or phased rates to be implemented over time; peak load rates or seasonal rates. During my tenure as a Commissioner, the Postal Service has offered several innovative rate proposals. The Commission seriously reviewed each one, and none was found unlawful.

Throughout the decade of the 1980s some people believed that the law prevented the Postal Service from experimenting with new services even though the

Commission had adopted rules for hearing requests for experiments. Finally, a joint Postal Service/Postal Rate Commission task force suggested a number of ways to facilitate interaction between the two agencies. Recently, the Postal Service has requested a number of experiments and the Commission has provided expedited consideration of those requests.

A somewhat similar situation existed with regard to negotiated service agreements. For a number of years many people thought they were impermissible. However, the Postal Service has recently proposed a number of classification changes which essentially implemented negotiated service agreements. Again, these proposals were found to be consistent with the policies of the act, and have been approved by the Commission and the Governors.

I urge the Postal Service to continue to be innovative, and to take advantage of the wide latitude permitted by current law. Ideas that have proven appealing in other monopoly industries, such as phased increases, peak load rates and seasonal rates can be explored. The Postal Service should not assume that new ideas will be treated with hostility.

I hope that the Commissioners and the Governors can start to meet more regularly to discuss problems and explore new initiatives. These meetings could be preceded by an exchange of items of interest for discussion and might include a limited number of senior staff members. If it appears necessary, consideration could be given to establishing a new joint Postal Service/Postal Rate Commission Task Force to explore in depth opportunities for improved interaction. The Commission and the Postal Service can and should work as partners to assure that the nation's mailers have the opportunity to participate in an open, effective, and efficient rate setting process.

This concludes my testimony. I would be pleased to answer any questions.

RESPONSES FROM POSTMASTER GENERAL HENDERSON

INFORMATION PROMISED TO COMMITTEE MEMBERS DURING THE MAY 15 HEARING

Chairman Thompson asked for Mr. Henderson's response to PRC Acting Chairman Omas' statements that the Postal Service did not provide any new information to justify a higher rate increase and that we declined to reopen the case. Henderson responded, "obviously we do not agree...I will give this to you, for the record...what the current situation was in the Postal Service."

A. Attached is a June 5 letter to Chairman Thompson on this issue. (attachment 1)

Chairman Thompson asked what percentage of transportation costs is fuel?

A. Of the $5.583 Billion spent on identified transportation costs, $1 billion or 18% is fuel-related.

Chairman Thompson asked whether there was a 23 percent wage premium paid to postal employees as compared to private sector employees. PMG Henderson indicated that the Postal Service would provide economic information to support the proposition of the existence of a wage premium.

A. In considering this subject, the Postal Service is guided by Title 39, Section 1003(a) which states, in relevant part, as follows:

"It shall be the policy of the Postal Service to maintain compensation and benefits for all officers and employees on a standard of comparability to the compensation and benefits paid for comparable levels of work in the private sector of the economy."

As part of collective bargaining negotiations and any related interest arbitration proceedings, the Postal Service attempts to follow this wage and benefit comparability mandate. In support of its comparability position, the Postal Service relies on wage and benefit comparisons for postal workers as compared to workers in the private sector.

During the hearing, Chairman Thompson referred to a 23% wage premium contained in USPS testimony. Although we are not certain as to which testimony Chairman Thompson is referring to, the Postal Service did provide wage premium testimony in 1999 in the most recent interest arbitration proceeding, which concerned the labor dispute with the National Association of Letter Carriers, AFL-CIO. Based on econometric data provided by the Postal Service, it was argued that the wage premium for all bargaining unit workers was 19.2%. This level does not include postal benefits nor does it take into account skill and working condition variables that would increase the amount of the wage premium.

Mr. Henderson promised to provide to Senator Cochran a list of all eCommerce products and services, including "those that have been canceled and those that have positive net incomes."

A. Following are the former e-commerce services that the Postal Service no longer offers:

Deliver America
Electronic Commerce Services
Global ePost
Post Office Online
WEB Interactive Network of Government Services (WINGS).

Each of these discontinued services was terminated by the respective product managers, with appropriate management consultation.

Following are the Postal Service's current e-commerce services:

Electronic Postmark (EPM/SEDS)
ePayments (eBillPay)
MoversGuide.com
NetPost Cardstore
NetPost.Certified
NetPost Mailing Online
PosteCS
Postal Store.

Shipping Supplies Online
EPM/SEDS
ePayments (eBillPay) (includes Pay@Delivery)
NetPost Certified
NetPost Mailing Online
-certified mail
-postcards
NetPost Cardstore
PosteCS
Certificate Authority/Public Key Infrastructure (CA/PKI) / ID
Hi Citizen
USPS.com
Microsoft bCentral solutions
MoversGuide.com
Postal Store

Senator Cochran asked "When can we expect to hear about" the comprehensive plan for "statutory reform" recommended by GAO.

A. Attached is a letter to Senator Lieberman on this issue. (attachment 2)

Senator Collins asked how much the Postal Service has spent on sexual harassment cases nationwide?

A. The Postal Service has not tracked expenditures resulting from sexual harassment lawsuits on a nationwide basis. We are in the process of compiling this information and will provide it to the Committee in the near future.

BOARD OF GOVERNORS

UNITED STATES POSTAL SERVICE

Attachment 1

June 5, 2001

Honorable Fred Thompson
Chairman
Committee on Governmental Affairs
United States Senate
Washington, DC 20510-6250

Dear Mr. Chairman:

During the hearing on May 15 you inquired about the Governors' decision not to ask the Postal Rate Commission to reopen the record in the most recent rate case (Docket No. R2000-1), following the Commission's initial Recommended Decision. The Commission had cut the Postal Service's revenue requirement by $1 billion, and the Governors restored the cuts in exercising their authority to modify the recommended rates. I would like to provide you with some additional information regarding your concerns.

During the course of litigation of the case, the Postal Service had provided the Commission with updated cost information for the record. The update demonstrated that the Postal Service's need for revenues in the test year had increased substantially since the case had been filed. Although the Commission used most of the updated information, which had the effect of increasing the Postal Service's revenue requirement, it then chose to reduce—by almost $700 million—the statutory contingency provision that covers unforeseen events and unpredictable changes from forecasts. The reduction in the contingency, together with other cuts made by the Commission, cancelled out the effect of the updating exercise.

As to the contingency, our primary disagreement with the Commission's Recommended Decisions was not over the accuracy of the updates that were made part of the record, or what might have occurred after the record closed as a result of changed circumstances. Rather, we disagreed over whether the Board's choice of a contingency provision was reasonable and established on the record. As we explained at length in our most recent Decision, the record adequately supported the Postal Service's provision for contingencies as a reasonable policy choice. The Commission substituted its own judgment for that of the Board of Governors and included a much lower provision for contingencies of 1.5 percent. We believe that the Commission erred in its determination, and exceeded its authority in so doing. Thus, the reduced revenue requirement was not a matter of differences over cost or revenue estimates, but one of a judgment regarding contingencies. We, and the courts that have examined the issue, believe the statute authorizes the Board, not the Commission, to determine the contingency provision.

With respect to changes that might have occurred since the record closed, the Governors did not rely on recent estimates of a net loss of $2 to $3 billion to support their modification. We understand that the record would have had to be reopened for the purpose of covering this loss. We did not ask the Commission to do so, because such a course of action would have necessarily resulted in a new omnibus rate case requiring lengthy proceedings, notwithstanding the Commission's stated intent to proceed expeditiously. Accordingly, we chose not to engage in continuous ratemaking, opting to allow this case to reach a conclusion. The bottom line is that the modified rates provide the level of revenue already demonstrated on the record of the case, and the Postal Service will do its best to operate with these revenues as long as it can.

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The fact that subsequent events have proved that the Board's judgment concerning risk in the near future was accurate, and that the Commission's judgment was wrong, certainly might reinforce our conclusions. We never relied on such events, however, or maintained that knowledge of them was necessary to vindicate the Postal Service's position on the reasonableness of a 2.5 percent contingency provision. As we explained in our modification decision, the provision for contingencies is not an estimate of what will happen, and need not be proven as such. Rather, it is a judgment, a measure of the level of risk that the Board is willing to take that events will occur that could cause the Postal Service to fail to break even. It is our contention that the testimony put on the record by the Postal Service's revenue requirement witness, by its Chief Financial Officer, and by the renowned economist Dr. Victor Zarnowitz of the Conference Board, firmly established that the 2.5 percent contingency was reasonable. Thus, there was no need to reopen the record and risk further delay of recovery of this needed revenue.

Moreover, it is unlikely that reopening the record would have altered the outcome here, since the primary difference between the Governors and the Commission was not over specific cost or revenue estimates, but over who exercises the authority to determine the amount of the contingency provision, and whether the 2.5 percent contingency provision was reasonable. As we explained in detail in our Decisions, we believe that the Commission, in evaluating this matter, relied too heavily on the past to predict the likelihood of unforeseen events in the future. The Postal Service presented evidence on the record indicating that economic uncertainty was increasing, and that the 2.5 percent contingency provision would be needed in case the economy took a downturn. The Commission declined to defer to the Board's judgment, and chose to disregard the testimony to this effect provided by our CFO and by Dr. Zarnowitz. (Dr. Zarnowitz was recently quoted in an opinion column by Robert J. Samuelson in The Washington Post, which summarizes quite nicely the danger of relying on past performance to predict the future, as the Commission did. A copy of that article is enclosed.)

Had the Commission recommended rates and fees that covered both our contingency amount and the updated cost information provided during the course of the case, it is likely that we would have approved those rates, without the need for further proceedings. The existing record would have supported that action, as it supported our modification decision without the need for further updating.

Sincerely,

Robert F. Rider
Chairman

Enclosure

cc: Board of Governors

Never a Crystal Ball When You Need One

By Robert J. Samuelson

Wednesday, May 16, 2001; Page A23

The economy's slide has one familiar feature: Few, if any, economists predicted it. We should not be surprised. Economists routinely miss the turning points of business cycles and, indeed, have missed most of the major economic transformations of the past half-century, whether for good or ill. The great boom of the 1990s was barely anticipated. The same was true of other upheavals: sporadic "energy crises," the sharp rise of inflation in the 1970s, its dramatic fall in the 1980s and various shifts in productivity growth.

At present, most forecasts are bravado and bluff. Hardly a day passes without the government or private industry disgorging some economic statistic that is instantly seized upon to demonstrate that (a) "the worst has passed" or (b) "the economy is tanking." In the first quarter the economy grew at a 2 percent annual rate—better than expected. A good omen. But in April unemployment rose to 4.5 percent—worse than expected. A bad omen. Also, productivity (output per hour worked) dropped for the first time in six years—another bad omen. On the other hand, stocks have recovered from recent lows—a good omen. The truth is that no one knows.

Even the brightest mortals cannot peer far into the future. (Alexis de Tocqueville once wrote of the French Revolution: "Never was such a great event ...so well prepared and so little foreseen.") As recently as last October the "consensus forecast" of 52 economists surveyed by the Blue Chip Economic Indicators—a newsletter—was for a strong 3.5 percent growth in 2001. The "consensus" is now down to 2 percent, and though few economists yet predict an outright recession (usually defined as two consecutive quarters of falling output), this clearly is a possibility. The errors have not reduced economists' eagerness to prognosticate—only their credibility.

Their picture of the future usually reflects the recent past, because that's what they know. They underpredicted inflation in the 1970s because it had been low in the '60s and they expected it to stay low. They overpredicted inflation in the 1980s because it had been high in the '70s and they expected it to stay high. This backward vision also explains the optimistic bias of today's forecasts. Because the economy thrived in the late 1990s, economists expected it to continue thriving.

Perhaps the trophy for optimism goes to Merrill Lynch's economists. "We're sticking with our view that the U.S. economy will avoid an outright recession," they wrote recently. "Payrolls [payroll jobs] fell for the second consecutive month in April, plunging by 223,000. There have almost never been two consecutive payroll declines that didn't mark a recession. But the Fed has never eased [interest rates] as rapidly as it is currently doing, which is why we still think a contraction can be avoided." We'll see.

As a rule, forecasters rely on computer models that try to predict how, say, a rise in consumer spending might affect profits, investment and employment—and how these changes might feed back into inflation, stock prices, interest rates and (again) consumer spending. The idea is that present behavior reflects past behavior, as reflected in various economic statistics. This is not as simple as it sounds. Not only are statistics incomplete and imperfect, but behavior often changes in erratic ways.

Every business cycle creates new experiences and expectations that alter how people and businesses think and act. What was true a year ago or a decade ago may no longer be true. Optimism and pessimism feed on themselves. "In long business [expansions], there will be a lot of investment—and then overinvestment," says Victor Zarnowitz, a retired economist from the

University of Chicago and a respected student of business cycles. Certainly that's the case now—computers and telecommunications equipment being obvious examples.

Worse, forecasting models exclude almost everything interesting and disruptive in life: politics, nationalism, technological change, the weather, greed, fear, ambition, ignorance and stupidity. Naturally, blunders occur. To explain and excuse these lapses, economists often blame "shocks." A "shock" is a catchall label that covers almost anything that the model misses and that spoils the forecast. Oil and energy "shocks" (big shifts in prices) are a common variety. So are food-price "shocks." In 1998 some economists cited a "demand shock"—an unpredicted spurt in consumer spending—that probably prevented a recession. "Shocks" contradict the premise of the models, which is that economic change is gradual and comprehensible.

Most of the time it is. This is why economists and models seem right more often than not. Today is usually like yesterday, which was like the day before. You too can make a credible forecast. Just read the newspapers and make a few minor adjustments to existing economic indicators. The chances of being wildly wrong are slight; inflation won't jump from 3 percent to 13 percent in a few months. Because this is true, economic forecasts cluster together. The clustering also reflects herd behavior. To stray too far from your peers is to risk looking foolish—alone. There's less danger in being wrong with everyone else.

We call this exercise forecasting, but of course it isn't. It's telling people what they already know or might know by examining the available information. It creates an illusion of understanding. The trouble is that there are times when radical and dramatic changes do happen, and at these moments economists are almost as clueless as everyone else. Their crystal balls are cracked. The paradox is that economic forecasts are least reliable when they are most needed.

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JOHN E. POTTER
POSTMASTER GENERAL, CEO

Attachment 2

June 25, 2001

Honorable Joseph I. Lieberman
Chairman
Committee on Governmental Affairs
United States Senate
Washington, DC 20510-6250

Dear Mr. Chairman:

On April 24, 2001, Mr. Bernard Ungar, director, Physical Infrastructure Issues, of the General Accounting Office (GAO), wrote to former Postmaster General William J. Henderson. As provided by 31 U.S.C. 720, the head of a federal agency is required to submit a written statement to the oversight committees on actions taken on recommendations from the GAO. This letter fulfills that requirement and responds to your June 14 follow-up letter regarding GAO's recommendations.

Comptroller General David Walker testified before the House Committee on Government Reform on April 4. Two recommendations were made at that time (as summarized in Mr. Ungar's April 24 letter):

(1) "The Service should provide summary financial reports to Congress and the public on a quarterly basis. These reports should present sufficiently detailed information for stakeholders to understand the Service's current and projected financial condition, how its outlook may have changed since the previous quarter, and its progress toward achieving the desired results specified in the comprehensive plan."

(2) "The Service should develop a comprehensive plan, in conjunction with Congress and other stakeholders, such as the postal unions and management associations, customers, and the Postal Rate Commission, that would identify the actions needed to address the Service's financial, operational, and human capital challenges, and establish a time frame and specify key milestones for achieving positive results."

Since the time of this April 24 letter, my staff has met with the GAO staff on a number of occasions. Deputy Postmaster General and Chief Marketing Officer John Nolan and Chief Financial Officer and Executive Vice President Richard Strasser have met with the comptroller general, and I have spoken with Comptroller General Walker personally. Together we have developed a plan of action that will, we believe, be fully responsive to the GAO's recommendations. Further, we plan to continue to stay in close touch to address the concerns that Comptroller General Walker raised when he noted that the transformation of the Postal Service is at risk.

Financial Reports

With respect to this recommendation, Chief Financial Officer Richard Strasser makes a quarterly presentation of financial results to the Board of Governors at its public meetings. Mr. Strasser has met with the GAO and has discussed methods to provide additional transparency related to its financial condition. A major step in that direction, and in direct response to GAO's recommendation that summary financial reports to Congress and the public be made on a quarterly basis, in the near future we will place our Quarter III Financial Statements, similar to

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what publicly traded enterprises provide, on our Web site at www.usps.com. We will continue this practice quarterly, with the audited fiscal year report as the Quarter IV version. Our *FY2000 Annual Report* is also available on the Web site.

Comprehensive Plan for Transformation

In the twenty-first century business environment, for the Postal Service to continue providing the people of the United States affordable, high-quality universal service without relying on taxpayer subsidy, the Postal Service must be transformed to meet a new and rapidly evolving set of financial, operational, and human capital challenges. Over the last five years, the Postal Service, the Congress, and other stakeholders have invested a great deal of thought and effort in developing needed postal reforms. That process continues. In his testimony on April 4, Mr. Walker announced that the GAO has placed the Postal Service's transformational efforts and long-term outlook on its *High-Risk List.* To introduce a new planning framework for public consideration of needed postal reform, the GAO has recommended that the Postal Service work with stakeholders to offer a formal, comprehensive plan for accomplishing transformation. Building and extending from work already completed, such a plan could provide the opportunity for the Congress and the public to evaluate what kinds of postal policies and structures are most appropriate for the twenty-first century. We agree that such a plan is needed and have begun the work of coordinating with affected stakeholders to develop such a plan.

Our *Comprehensive Transformation Plan* will provide a first step in describing our future direction and the pathway to reaching our goals. The *Plan* will in fact consider multiple pathways and include a range of options for both administrative and legislative changes. The *Plan* will discuss the pros and cons of each option and appropriate time frames and milestones for accomplishing the required transformation. Our *Plan* will address the three key themes that Comptroller General Walker has highlighted: the financial, operational, and human capital challenges that must be met to sustain our universal service mission. But most importantly, the transformation plan, as the comptroller general points out, must address fundamental legislative reform.

Work on the transformation plan is proceeding in tandem with continued efforts to restore the Postal Service to a sound financial condition in spite of the current economic slowdown. As discussed with the committee in your recent oversight hearing, from the beginning of this calendar year, the Board of Governors and management of the Postal Service have initiated numerous steps to cut costs at a time when the sluggish economy held revenues below expectation. We have achieved record productivity and maintained our broad service commitments during this time. These efforts to restore balance between income and expense will continue as we work on planning for longer-term structural reform.

The U.S. Postal Service (USPS) mandate is to "breakeven" over time. Limited flexibility has been provided to bring down the debt in the statue or in our rate regulations. The rate process allows for reduction of debt through Prior Year Loss Recovery (over a nine-year period).

The rate process also provides for a contingency in the test year, which if unused, can help pay down the debt. There are a number of economic assumptions made when projecting the revenue requirement in the test year of a rate case. Should these assumptions go badly for the USPS, the contingency is used to cover the added costs or revenue shortfall.

Finally, revenue growth would, in theory, be the most effective way for the USPS to generate positive financial results to permit debt reduction. If growth is better than plan and/or costs are lower than plan, there is an opportunity to pay down debt. However, the process is flawed in that the burden of the rate process does not allow for annual increases in price. The limited revenue growth opportunities (particularly with First-Class Mail) and the inflexible rate process point to the need for pricing reform.

With respect to human capital transformation, we have an extensive effort under way to restructure the workforce, to reduce administrative staffing, and to reduce bargaining unit positions in accordance with applicable collective bargaining agreements. We are investing extensively in preparing future leaders, in making employees more productive, in improving labor relations, and leveraging their contribution with enterprise technology.

In a search for transformational changes that might be accomplished by the Postal Service and its customers together under existing authority, we have helped to organize a Mailing Industry Task Force to explore specific proposals for improving service and efficiency in our operations. I am personally meeting with our unions and management associations to listen to their views and work with all of them to explore what can be done to improve the long-term prospects for continued success of this vital public service, to which we are mutually committed.

We are working to improve the substantive quality of our interactions with our stakeholders. In the continued effort to advance needed legislative changes, on May 15, the Board of Governors wrote to your committee to provide its views on the kinds of reforms that seem needed to put the Postal Service on a more stable, businesslike basis for the preservation of universal service. These reforms address fundamental issues including the definition and preservation of universal service, more market-driven structures for pricing and product changes, and labor and employment reforms. We recognize that successful legislative reform will require building a coalition across a broad range of postal stakeholders. We continue to meet with members of Congress to learn their views and hear their concerns. We will be working with the Coalition to Preserve Universal Mail Service and others who also seek legislative reform, to exchange views, develop options, and advance the process.

The legislative reform process is dynamic. As we outline our plan to respond to the GAO's recommendations, the shape of the Comprehensive Plan is likely to change to accommodate the state of the discussion of postal reform legislation.

Recognizing that the timing and scope of our plan may change depending upon the legislative process, we expect to conduct discussions of the broad plan with stakeholders during the July-August time frame and to review the results of these conversations with the Board of Governors at their September meeting. We should then be ready to provide everyone with a draft Comprehensive Plan by September 30 of this year. Future updates to the plan will very likely be required.

The process of structural transformation of the Postal Service will be an ongoing, challenging task requiring regular communication and consensus building with all stakeholders. We have been participating in this important discussion of public policy since 1995 and this subject will continue to be a priority for the Postal Service. A transformation plan will need to propose an ongoing, evolving, common vision for the future of universal postal service for the benefit of all of America.

In summary, we find the GAO's recommendations to be very helpful, and we look forward to our ongoing interaction with Comptroller General David Walker and his staff.

Sincerely,

John E. Potter

John E. Potter

Statement of
Karla W. Corcoran, Inspector General
United States Postal Service
Before the
Senate Committee on Governmental Affairs
May 15, 2001

Chairman Thompson and Members of the Committee, on behalf of the Office of Inspector General (OIG), United States Postal Service, I am pleased to submit this written statement concerning actions the Postal Service can take to improve its performance, accountability, and financial position.

Congress created an independent OIG for the Postal Service in 1996. I am the first independent Inspector General for the Postal Service under the Inspector General Act and have held this position since January 1997. As you know, under the Inspector General Act, my office conducts independent audits, reviews, and investigations of postal programs and operations. Therefore, we are uniquely situated to bring to Congress and Postal Service stakeholders an independent assessment of postal operations because we are knowledgeable of postal operations but do not report to Postal Service management and are not under their control.

This statement brings to your attention some of the issues regarding opportunities to improve critical management practices of the Postal Service, including contracting, budget and return on investment, labor management, systems development, computer security and privacy, and strategic planning. In one review, we identified almost $1 billion in cost avoidances over a 7-year period for a project to establish a nationwide toll-free response line.

In another project, we identified that outsourcing a major repair function could cost the Postal Service $1.4 billion more over a 10-year period forecasted. In addition, our other projects have identified almost $515 million in fines, recoveries, restitution, potential savings, and cost avoidances on postal operations over a number of years. Finally, we have identified $69 million in unrecoverable costs.

We would like to note that the Postal Service has generally been receptive and responsive to issues we have brought to their attention over the last four years. Because of their willingness to address these issues, we are developing an effective working relationship.

The Postal Service is projecting a revised loss of $1.6 to $2.4 billion this year, after the Governors of the Postal Service voted unanimously to modify the April 10 decision of the Postal Rate Commission by raising some rates on July 1. The Postal Service has indicated that the main reasons for this projected loss include reduced revenues from the Postal Rate Commission's decision, cost-of-living adjustments, and a continued soft economy. Previously, the Postal Service had been projecting a $2 to $3 billion loss. We are now in the process of assessing the reasonableness of this projected loss, however, it is apparent that the Postal Service is facing significant financial challenges as evidenced by the deterioration in its current financial condition.

While this Committee is assessing the Postal Service's call for reform, the Postal Service must still address their critical management and financial practices. Although progress has been made in recent years to improve practices, we believe that continued effort must be given to improving performance and accountability throughout the Postal Service. Specifically, we believe:

- Contracting activities need proper control and oversight to improve operations and to prevent fraud, waste, abuse, and mismanagement;

- Performance data and financial information must be reliable for senior managers to make sound business decisions;
- Labor management and personnel practices must be improved;
- Mail processing systems must deliver;
- Computer security and privacy must preserve the customers' trust; and
- Organizational structure and strategic planning must address the core mission.

Critical Management Practices

Although the Postal Service is seeking reform, we believe there are many improvements it can make today to strengthen its performance and improve efficiency. The following sections discuss the major issues that the Postal Service needs to address.

Contracting activities need proper control and oversight to prevent fraud, waste, abuse, and mismanagement

The Postal Service awards $9 billion a year in contracts. We have found that the Postal Service has not always followed its own procurement policies or sound contracting principles. Over the last four years, our reviews have disclosed that such contracting practices have resulted in $434 million in monetary findings including fraud, waste, abuse, mismanagement, and other recoveries on postal contracting programs.

As a result of our efforts and with the cooperation of Postal Service management, the Postal Service recovered over $12 million from a major telecommunications

contractor and can avoid an additional $58 million in erroneous billings. Because the Postal Service did not adequately monitor contractor performance, it was repeatedly billed for work that was not performed and for substandard work. Postal Service management is reviewing all future bills to ensure correct billings, which should result in future savings.

In another recent case, a married couple who were Postal Service employees defrauded the Postal Service of more than $3 million because internal controls were ineffective. One spouse approved nonexistent purchases submitted by the other. The couple then fled to Venezuela with the proceeds and converted the stolen money into foreign investments, jewelry, and real property. Both employees were caught, returned to the United States, and convicted. As part of their sentence, the couple was ordered to repay over $3 million. Forfeiture actions to recover the money are currently underway. In order to prevent such frauds in the future, the Postal Service needs to ensure that appropriate internal controls exist and are enforced and that systems and data are available to validate contractor charges for services rendered or work performed.

The Postal Service awards millions of dollars annually in cost reimbursement contracts. Our work has shown the Postal Service has not always reviewed and approved its contractors' cost accounting systems before awarding cost reimbursement contracts. This impairs the Postal Service's ability to effectively review contractor billings, creates the potential for billing frauds and may result in excess charges to the Postal Service.

For example, we identified significant deficiencies in a major contractor's estimating system and concluded that the Postal Service could not rely on any of the contractor's proposed costs. This contractor has received more than $1 billion in postal contracts to date. Reliance on this system could result in the Postal Service paying for costs that are not associated with postal work. To date,

we have questioned $37 million in proposed costs from this contractor, and our work on reviewing other contracts is continuing.

We have found situations where contractors were involved in writing requirements in which they had an interest. For example, in one case a contractor received a series of sole source contracts, valued in excess of $300 million, to provide these requirements. Under federal government contracting regulations, this conduct would be specifically prohibited; however, under postal policies it is not specifically prohibited. We determined that if these contracts had been competitively bid, the Postal Service could have saved $53 million.

We have also identified repeated examples of contractors providing multi-million dollar services without addressing essential contract safeguards. The Postal Service has used "letter contracts" and "strategic alliance agreements" that do not contain adequate provisions to protect the interests of the Postal Service. The use of strategic alliances in the Postal Service is a growing practice, particularly in its electronic business initiatives. For example, in one major electronic commerce initiative, the Postal Service entered into a long-term relationship with a contractor to provide new electronic commerce services. The contract did not fully address computer security, the privacy of Postal Service customer information, and audit rights. One clause that was included could have restricted the right of the Postal Service to investigate criminal activity relating to the contract. Although these deficiencies were brought to Postal Service management's attention almost one year ago, the contract still has not been amended to address these issues.

Our work further identified instances where contract management could be improved to support contracting decisions and the review of contractor billings. We have identified many instances where available information did not adequately support payments to contractors. We also determined that quality assurance procedures and training of Postal Service contracting officials

needed to be strengthened to properly monitor work performed by contractors. For example, in one investigation we determined that the Postal Service paid over $800,000 for asbestos abatement work that was either overbilled or not performed. As a result of our investigation, Postal Service management ensured that the work was completed, initiated actions to obtain refunds for all overbillings, and ensured that the contractor reimbursed the additional costs that were incurred by the Postal Service.

The most recent example of inadequate quality assurance was identified after an ongoing investigation uncovered a contractor who provided defective steel mail sorting units, steel letter-bundle drop units, and other equipment valued at over $11 million to the Postal Service, between January 1997 through November 1999. The investigation focused on the contractor's fabricated inspection records and misrepresentations as to whether contract specifications were met. During the performance of these contracts, the contractor is alleged to have falsely billed the Postal Service 3,500 times. The contractor faces a possible $35 million fine and unspecified actual damages could bring the total even higher.

Another example of poor controls deals with inadequate monitoring of contractor performance. In one case, a contractor was responsible for reporting performance information on a major 10-year, $3.6 billion equipment network. As part of its responsibilities, the contractor reported on its own performance and developed the data that the Postal Service used to approve invoice payment.

We also note that the Postal Service is exempt from standard federal contracting rules to enable it to realize greater efficiency and operate in a more businesslike manner. As demonstrated in the examples above, our reviews of postal contracting practices suggest that although the Postal Service has realized some efficiencies, they have also weakened important internal controls. We believe that while a strict adherence to federal contracting regulations is not needed, there is a clear need to strengthen internal controls throughout all postal

contracts. These controls are the Postal Service's first line of defense against fraud, waste, abuse, and mismanagement.

Finally, the Postal Service recently entered a strategic partnership with FedEx for the transportation of Express, Priority, and First Class Mail. The Postal Service believes this partnership will enable it to provide more reliable service, reduce costs, and manage future cost growth. We recognize that the strategic partnership is a significant business decision for the Postal Service that has inherent financial and managerial risks. We have recently initiated an audit of the strategic partnership.

Performance data and financial information must be reliable for senior managers to make sound business decisions

During some of our reviews, we found that Postal Service officials did not always effectively plan, control, and allocate organizational resources to invest in and support the Postal Service's goals. Further, we found that the Postal Service could improve its estimates for return on investments so that they can be achieved and supported. The Postal Service is a $65 billion business and must require that timely and accurate information be provided to senior managers for making informed business decisions. While we recognize the challenge in managing a budget of this size, Postal Service management can more effectively control and address its projected budget shortfall with accurate information to support budget estimates.

In our review of the process used to manage the Postal Service Headquarters' $4.1 billion budget, we noted that 50 of the 100 program budgets that comprise this figure were not based on current or complete studies and analyses to ensure that program funding requirements were appropriate. Therefore, Postal Service officials could not be assured that the programs were appropriately staffed and funded.

The Postal Service tracks expenses when paid, but it does not track expenses that have been incurred but not paid. While we have been told that this does not affect the overall postal budget because the major expenses are salaries and benefits, it is very significant at the program level. At this level, other expenses, such as contracts, travel, and goods and services, are of major concern. Vice presidents and program managers have expressed concerns to us regarding the inability to monitor expenses on a timely basis. In addition, without this information, it is difficult for them to effectively develop, justify, and defend program budgets.

The Postal Service uses a detailed process to justify and analyze the cost/benefits of projects over $5 million for major equipment programs and facilities. Over the last four years, we noted that management presented many programs for approval without adequate documentation and analysis. We have recently completed a comprehensive review of this process, in which we evaluated the methods used by the Postal Service to validate and monitor its annual expenditures of several billion dollars. We are also reviewing performance measurements to determine whether they are complete and are reported promptly to senior Postal Service managers. These measures will allow managers to track subsequent program performance and adjust funding in order to ensure that Postal Service funds are justified, cost-effective, or beneficial to their operations.

The Postal Service uses return on investment to determine the economic viability and cost benefits of its programs. We continue to question some of the Postal Service's return on investment projections because postal management does not always possess the data to make these projections. Lack of accurate data could have a direct impact on postal income projections.

For example, we have looked at return on investment on numerous postal projects. In each of these reviews, we believe that Postal Service management

could have used more reliable and complete data. In one instance, a $500 million automation project for 23 sites was projected to have a return on investment of approximately 5 percent. However, our analysis showed that the return on investment at the time of approval should have been almost a negative 9 percent, and most recently showed that the actual return on investment for the nine sites that have been operational for a year was a negative 6 percent. Therefore, the approval of this investment was based on inaccurate information.

We reviewed a program to repair postal equipment and found the Postal Service estimated savings from the program to be $300 million over a 10-year period. Instead, we found that the program, as deployed, may not result in the forecasted savings, but will result in costing the Postal Service $1.4 billion more over the 10-year life of the program than forecast.

We are also concerned that the Postal Service has entered into a number of agreements that guarantees revenue to its business partners. The Postal Service assumes the risk in the venture, even though it does not know what the revenue will be.

For example, in one recent agreement the Postal Service provided an annual revenue guarantee over the 10-year life of the contract, even though the Postal Service has little or no experience in this area. To date, in an ongoing review, we have not been able to verify how the revenue guarantees were derived, but the amount of revenue guaranteed appeared unrealistic to us. Further, the Postal Service has not yet been able to provide sufficient information to justify the revenue guarantee. Furthermore, in the year since this program commenced, Postal Service management told us that revenues from the program have been below their original projections. The Postal Service is currently revising its projections based on the economic slowdown.

Labor management and personnel practices need to be improved

Controlling personnel costs is imperative for the Postal Service because these costs account for over three-quarters of its operating budget. Labor management relations are significant to the Postal Service's survival. Poor labor management relations can have a negative impact on employee morale and productivity. Our work has shown that the Postal Service has had difficulty in labor management relations, and we believe there are opportunities for cost savings.

One of the concerns that has continued to get media, Congressional, and employee attention is the Postal Service's pay for performance program, which covers 84,000 employees. We reviewed this program and questioned whether the Postal Service should be making payments under the program at the same time it was requesting a rate increase, considering a reduction in workforce, and projecting a net profit that was less than the projected payout. Since then, we have learned that the actual payments were $197 million; at the same time, the Postal Service lost $199 million.

The Postal Service justifies its pay for performance program, stating that productivity improvements are driven by this program and are promised at the beginning of the year before knowledge of actual profit or loss is known. In addition, the Postal Service believes that without this program it would not have achieved its reported record productivity improvements. We are continuing to review this program to determine whether it actually enhances productivity.

As part of its efforts to improve working conditions, the Postal Service commissioned a study on violence in the workplace. The study concluded that although employees believed they were at greater risk to be victims of workplace violence than the average worker in the United States, actual results did not support this belief. The Postal Service has acknowledged these concerns, and

continues to take actions to address these issues, such as improving its threat assessment capability and ensuring that managers are accountable in this area. In addition, the Postal Service has established a workplace environment improvement program to enhance working conditions.

However, we continue to receive allegations from employees who believe they have been harassed, intimidated, and subjected to violence. We continue to find this troublesome and believe it has a potential impact on the profitability of the Postal Service because of increased grievances, Equal Employment Opportunity (EEO) complaints, work slowdowns, and morale issues.

Recently, we conducted four reviews documenting employee allegations that certain Postal Service managers in New Jersey, California, South Carolina, and Alaska have used intimidation, harassment, and abusive management practices. In response to these reports, the Postal Service has taken steps at these facilities to improve the work environment by conducting climate assessments and initiating joint labor-management meetings.

The full cost of these problems to the Postal Service is difficult to assess. For example, the Postal Service is unable to provide the cost of processing the 126,000 grievance arbitration cases currently pending. While the Postal Service has developed a new grievance tracking system, it does not track costs. Knowing how much these employee-related problems are costing the Postal Service – and it could be in the millions of dollars – might give management more of an incentive to correct this situation.

The Postal Service has announced that with the projected loss, there could potentially be office closings and reductions in force. These events can be traumatic to employees and may increase workplace tension. The Postal Service needs to be able to react to any workplace incident that may arise from this tension. We do note, however, that the Postal Service has recently closed

23 out of 55 remote encoding facilities, primarily staffed by contractors, without adverse incidents.

Recently, we completed audits of 26 Postal Service districts' violence prevention and response programs. These reviews disclosed that the Postal Service effectively responded to violent situations. However, they need to proactively follow threat assessment procedures to prevent workplace violence. If such situations would erupt, the potential financial liability could be substantial. Further, even though the Postal Service is taking cost-cutting measures, reductions in this area would be inappropriate.

In the area of workplace safety, the Postal Service has potential liability in terms of:

- Substantial fines from the Occupational Safety and Health Administration, including treble damages if the violation is determined to be willful. Furthermore, significant violations have the potential for shutting down postal facilities.

- Workers' compensation claims, potential lost workdays of Postal Service workers, and claims for workplace injuries by Postal Service contractors and customers.

For example, in one review we found that Postal Service management did not ensure that appropriate action was taken to correct safety violations and safeguard employees. We were told that these unsafe conditions were not corrected due to concerns that repairs could cause mail delays.

Individual Postal Service managers have direct authority over large sums of money and resources, and when not judiciously administered, this authority may result in abuse, affect the public's trust in the Postal Service, and depress

employee morale. Following are examples where incidents occurred. In each case, Postal Service management took corrective action.

- A review of an EEO settlement agreement revealed that Postal Service managers have the authority to settle EEO complaints against themselves. In one example, a former vice president approved a settlement of $52,000 where he was the alleged discriminating official.

- Our reviews of relocation payments questioned the payment for employee moves of less than 20 miles when there appeared to be no benefit to the Postal Service. We identified over $240,000 in relocation expenses paid to two senior Postal Service officials for local moves, without full disclosure to the Governors.

- We found that some executives misused official vehicles and used Postal Service employees as chauffeurs for prolonged periods of time throughout the Postal Service. This occurred because controls over the vehicles were either inadequate or nonexistent. Specifically, we found over 520 instances (460 instances by one individual), involving nine executives, where inappropriate use took place. However, we could not determine the full extent of the misuse because of the lack of documentation.

Mail processing systems must deliver

Since 1998, the Postal Service has deployed $3.2 billion in automated mail processing equipment. We recognize that the Postal Service has been a leader in implementing and integrating automated mail processing equipment. While we support its initiatives to improve automation, we believe it is imperative that the Postal Service ensures that the technology works as intended and that their investments are sound. We reviewed $1.2 billion of this deployed equipment and identified instances of defects and immature technology. This condition existed

because the Postal Service does not always follow its process for ensuring projects are developed on time, within budget, according to requirements, and with expected benefits.

Numerous systems we reviewed have contained defects and immature technology. Because of these problems, the Postal Service often lowers the performance requirements in order to justify deployment. In most cases, Postal Service management then relies on manual labor to supplement the performance shortfalls of these systems, which contradicts the original premise for automated equipment investments. The following are examples of postal systems and the issues that existed at the time of deployment, and at the time of our reviews. Postal Service management recently informed us that these issues have been addressed. We will verify this information as time permits.

For example, the Postal Service expended $81 million on a mail processing automation project that was intended to process 15 mail trays per minute. When the equipment was deployed, the actual performance was only 10 mail trays per minute. Despite this reduced capability, Postal Service management chose to deploy the system without assessing the negative impact on the original savings used to justify the approval of this automation project. Therefore, it is unclear whether the Postal Service will achieve the anticipated savings on this project.

We reviewed another automation project originally intended to provide mail transport equipment at 42 postal sites at a projected cost of $500 million. However, because of a lack of reliable cost and performance information, $500 million will only provide for deployment at 23 sites. Furthermore, the deployment has been delayed by a year. In addition, we identified at least $27.9 million more in program costs than was originally projected.

After reviewing a $38 million robotics automation program, we determined the Postal Service was not capturing performance data to assess the effectiveness

of the program. Without this data, Postal Service management could not accurately determine what, if any, return on investment was achieved. In addition, only 73 of the 102 units purchased were installed, and 9 were subsequently removed by the receiving facilities. These 9 facilities determined, after deployment, that the units were of limited productivity and usefulness.

Finally, we reviewed a new $495 million system to replace existing retail systems at post offices. At the time of project approval, the system was designed to capture detailed information on retail transactions. However, we determined the system was not performing as originally required. As a result, Postal Service managers were not able to fully assess performance problems, identify issues to improve systems operations, or determine future training needs.

Computer security and privacy must preserve the customers' trust

In order to maintain the public's trust in the Postal Service, the security of its computers and the privacy of the information they contain must be ensured. This is particularly important in the electronic commerce area, where major private providers have been victimized by attacks on critical computer systems and the theft of customers' sensitive personal information. A breach in computer security could paralyze mail operations and result in a loss of revenue through the compromise of the Postal Service's electronic commerce operations. Risks in this area could increase exponentially as a result of the Postal Service's recently announced initiative to allow all Postal Service employees to connect to the postal network from home.

Recently, we led an international team of investigators in convicting a group of hackers that attacked computer systems, including a postal system, throughout the United States and Canada. The team is continuing to investigate other hacker attacks against postal systems originating from inside and outside of the Postal Service. The Postal Service has been very cooperative in our

investigations by identifying potential attacks and working with our office to resolve security incidents. We have also commenced a program to conduct penetration testing of computers throughout the Postal Service and, working with Postal Service management, have identified weaknesses in various systems that could, if not corrected, compromise Postal networks.

We are aware that computer security is a major Congressional priority. Last year, Congress passed the Government Information Security Reform Act to improve government computer security. The Postal Service has concluded, and we agree, that this Act does not apply to postal computer operations. However, our audit and investigative work has determined that the Postal Service does not meet the best practices recommended by the Act and that a comprehensive computer security program is needed to protect critical systems, postal operations, and electronic business initiatives. In response to our activities, the Postal Service has agreed to improve computer security.

One of the main concerns in electronic commerce today is the preservation of personal privacy and the continued availability of Internet services. The Postal Service has commenced an aggressive campaign to provide a variety of electronic commerce services, including selling postal products on-line and providing electronic services. We recognize that electronic commerce presents major challenges and we, as well as the Postal Service, agree that security and privacy concerns are paramount.

However, we have identified several security and privacy concerns in these areas that we have discussed with Postal Service management, including their protection of information and disaster recovery. We are not disclosing the details of these reports in this statement but would be happy to discuss them in private with the Committee. We commend the Postal Service for recently appointing a Chief Privacy Officer and Chief Information Security Officer, which will focus Postal Service management's efforts in these important areas.

We remain concerned that recent electronic business agreements with contractors and other business partners may have an adverse impact on postal computer security. Such agreements must contain language that will ensure postal computer security and privacy are not compromised. We have recommended that the Postal Service develop standard procedures to ensure that postal computer security and privacy are protected whenever there is connectivity between postal computers and the computers of their business partners. A breach in computer security in this area could result in theft of valuable information, jeopardize relationships with Postal Service business partners and customers, and result in a loss of revenue.

Organizational structure and strategic planning must address the core mission

In numerous reviews of postal programs, we have identified organizational issues such as fragmentation, decentralization, and a need for better focus, which affect the Postal Service's ability to control its costs and improve performance. An organization of the Postal Service's size, i.e., over 900,000 employees and 38,000 facilities, requires an efficient organizational structure that utilizes efficient business practices.

The following are examples of how decentralization and fragmentation affects the efficiency of the Postal Service:

- In one audit, we found that the Postal Service deployed a $38 million automated system to process mail trays to reduce operating expenses. The system was poorly planned and did not include all needed components. Because the decision to use the equipment after installation was not centralized, some managers who originally requested the system, unilaterally decided to remove the equipment and place it in storage. While on the one hand we understand managers not wanting ineffective

systems, on the other hand, the Postal Service has invested in this technology, much of which is now in storage or has been dismantled.

- The Postal Service incurred $23 million in repair expenses for a northwestern facility, originally purchased for almost $27 million. Postal Service management requested that we determine why this occurred. We found that because the decision to waive procurement requirements was decentralized, a Postal Service manager was able to bypass safeguards requiring a detailed engineering study prior to the purchase, which should have detected the building defects.

- We reviewed a revenue protection program and found that because the responsibility for the program was fragmented between Finance, Marketing, and area and district finance managers, each with a different focus, deficiencies were not prevented through early detection. Because of this lack of focus and fragmentation, we found that mailers perceived that they had been treated unfairly by the Postal Service. This process was an important tool for protecting postal monies and ensuring postage due the Postal Service was paid and expenditures for collection activities reduced.

Conclusion

In conclusion, while we believe that the Postal Service needs to improve in the areas noted above, we also recognize the challenge the Postal Service faces and applaud its efforts to meet this challenge. Specifically, we have noted that the Postal Service:

- Is aggressively seeking new technologies and business innovations to continue its role as a world leader in the delivery of communications and logistics services;

- Has made a concerted effort to improve computer security, including appointing a chief information security officer and chief privacy officer; developing a comprehensive strategy to tighten computer and Internet security; and creating a computer emergency response team; and

- Has recognized at the highest levels the impact of technology on its core business processes and undertaken a concerted effort to redefine its mission into the 21st century and beyond.

We believe that in addition to these efforts, the Postal Service must continually reexamine its mission, core business functions, and fundamental management practices. The Postal Service should also seek appropriate guidance from Congress on its mission and core business functions. The independent oversight provided by Congress and the OIG will continue to assist the Postal Service as they make decisions in these challenging times. In our view, in order to ensure the success of future Postal Service operations, Congress and Postal Service management need to address these issues.

United States Senate
Committee on Governmental Affairs

Supplemental Statement of Commissioner Ruth Y. Goldway
Postal Rate Commission

May 15, 2001

While I fully support the analysis and several recommendations put forward today by Acting Chairman George Omas on behalf of the Postal Rate Commission, regarding the rate setting process and the ability of the Postal Service to project trends in revenues and expenses, I would like to offer my perspective on the reforms necessary to assure an efficient and self-supporting national postal service.

As I have written previously, I believe that only sweeping legislative reform, that demonopolizes the letter mailing system and privatizes the USPS, provides the necessary solutions. During the recent postal reform debate, such wholesale reform has proven to be untenable because of conflicting entrenched interests. However, I believe there are several achievable adjustments Congress can adopt that would allow the USPS to function more like a private corporation and better serve the public.

1. I believe the Postal Service should be encouraged to work with private sector companies to extend the drop shipment of prepared mail deeper into its sortation and transportation network. The private sector has a proven track record of capturing cost savings through automation. The Postal Service record here, especially in flats, media mail and parcels, is poor. Strategically, the USPS's competitive advantage lies in its last-mile delivery connections to every household in the U.S. network. Congress should facilitate the process by which the USPS can reduce the number of BMCs, SCFs and DDUs. Unfortunately, by reacting to individual constituent complaints, members of Congress sometimes pressure the USPS to keep as many facilities and jobs as possible in each

district. USPS should be required to develop and implement a 5-year downsizing plan in this phase of its operations and be given assurances of congressional non-intervention. Because the USPS lacks the discipline of the marketplace, the Congress must motivate it to capture the savings from investments in automation and reduce institutional overhead.

2. The management bonus pay system should be tied exclusively to the size of the yearly operating surplus, and distributed to employees only if a surplus materializes. The current EVA bonus system measures too many factors unrelated to the marketplace and irrationally guarantees rewards in advance of demonstrated bottom-line performance.

3. The Postal Service boasts that it has attained "record service achievements," but average delivery times for First-Class mail overall have been getting longer for years. Under the Service's ODIS measurement system[1] average delivery times were 1.68 days in FY 1981, 1.83 in FY 1991, and 1.93 for the most recent four quarters.

The Postal Service should be required to develop service standards for all mail classes, measure that performance, and make such data public. The Commission can then better do the job it is charged with, evaluating "the value of the mail service actually provided each class or type of mail service . . .."[2] The Postal Service should not be allowed to improve its bottom line by imposing additional costs on mailers through inferior service. To quote Alfred Kahn, "buyers can be exploited just as effectively by giving them poor or unsafe service as by charging them excessive prices." "Price really has no meaning except in

[1] The ODIS system has been criticized for imprecision and that is correct; it probably understates delivery times. But is has been used for many years, so biases should be consistent, which means one can have some confidence in relative ODIS data.
[2] 39 U.S.C. §3622(b)(2).

terms of an assumed quality of service . . .." "Price regulation alone is economically meaningless."[3]

4. The USPS exemption from the truth-in-advertising laws embedded in the Federal Trade Commission Act should be removed.[4] Truthful information is a powerful source of marketplace competition. I have been publicly critical of past Postal Service advertising for its pricey Priority Mail product. First-class mail can be far cheaper, and often faster. Further, evidence uncovered during our last rate case showed the Postal Service often did not handle certified mail the way it advertises. Truth-in-advertising accountability would require USPS management to be more responsive to the public's need for accurate information and behave more like a private corporation.

5. Congress should further direct that the Service rethink its retail operations. If the Service can get stamps into the hands of consumers more cheaply by using electronic stamps on the net, contract offices or grocery stores, it should be allowed to sell the stamps at a discount to support such transactions.

Ultimately, we may need fewer traditional post offices. I realize this is a difficult political issue. Dollars and cents cannot measure all the value we get from post offices. And historic buildings owned by the Service must be preserved. But if the Service is correct that many post offices are big money losers, then efficiencies in operations need to be developed. Perhaps an unprofitable post office could add a retail Starbucks counter or a branch bank office. Perhaps post offices could be located at city halls in smaller communities, or in frequently visited retail stores such as supermarkets. Perhaps the real estate management and acquisitions operations of the Postal Service should be

[3] Alfred E. Kahn, The Economics of Regulation: Principles and Institutions, Vol. 1, p. 21.
[4] The FTC has no jurisdiction over not-for-profit corporations. 15 U.S.C. §44.

privatized or contracted out so that cash from the increased value of long-held properties could be generated or lease revenues maximized.

The long-term strategic value of the USPS retail network and its community support functions need a thorough analysis separate and apart from the frantic search for quick-fix savings. The Congress could require such a report from the USPS or create its own commission to review this complex issue.

During my years of service as a Postal Rate Commissioner, I have not been shy to criticize the USPS, and I frequently expressed concerns about its ability to project revenue and manage expenses during the public hearings in our most recent rate case. Yet, in its defense, private sector companies have made projections that are way off base and often lose money in experimental start-up operations. The difference is that the management in private sector companies is held accountable.

As long as the Congress maintains the USPS's current ownership and management configuration, the additional oversight suggested by Acting Chairman Omas as well as those recommendations I put forward here will be necessary.

Thank you for your careful consideration of these comments.

Thomas A. Schatz
President

May 9, 2001

The Honorable Fred Thompson
Committee on Government Affairs
340 Dirksen Senate Office Building
Washington, DC 20510

Dear Chairman Thompson:

On behalf of the one million members and supporters of the Council for Citizens Against Government Waste (CCAGW), I would like to thank you for holding an oversight hearing on the United States Postal Service on May 15th. CCAGW is deeply concerned with the unjustified and counterproductive postal rate increase that was recently imposed by the USPS, as well as its intention to embark on yet another rate increase early this summer.

The Senate Government Affairs Committee has a well-timed opportunity to demand unambiguous answers from USPS officials on important questions about its financial woes. For years, the USPS has been the poster child of waste, fraud, abuse and mismanagement. Just last month, as you know, ABC's "Good Morning America" documented serious mismanagement at the USPS, including: $200 million in "performance" bonuses for Postal Service executives during a year the Postal Service lost $199 million; the payment of moving expenses totaling nearly $250,000 for two USPS executives to move less than 10 miles, just so they could be closer to work; and the abuse of chauffeured limousines used to shuttle Postal Service executives back and forth from home. Your comments during that interview were precisely on point: the USPS is indeed in a "sorry state of affairs."

In addition to these flagrant examples of the USPS wasting taxpayer money, the agency was recently placed on the General Accounting Office's "high risk" list for being most susceptible to waste, fraud and abuse. The USPS inspector general identified $1.4 billion in waste, fraud and abuse that has yet to be corrected.

Americans are being forced to subsidize this flagrant waste. Users of the mail are captive of a chronically mismanaged monopoly and can't vote with their feet. Since the USPS maintains a government granted monopoly on first-class mail delivery, any rate hike is in effect a tax increase, which falls disproportionately on seniors and low-income individuals and families. It is outrageous for the USPS to go to the well again and again for rate hikes without first ending its disgraceful inefficiency, mismanagement, poor productivity, waste, fraud and abuse.

Thank you for attention and oversight into this matter. We look forward to your holding the USPS accountable for its actions and unjustified rate increases.

Sincerely,

Thomas Schatz

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FUTURE DIRECTIONS IN POSTAL REFORM

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Difficulties of Deregulation When Wage Costs are the Major Cost*

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1. INTRODUCTION

Most regulated industries undergoing deregulation are capital intensive. In the existing cost-of-service regulatory framework, the primary concern is that guaranteed a competitive return on capital, the regulated firm has insufficient incentive to be cost efficient. In deregulating firms in such industries the return on capital is permitted to vary directly with the firm's performance. Firms that restrain costs and increase revenue can earn higher profits, while those that fail to do so see profits fall below levels assured under the prior regulatory regime. The assumptions in deregulating such industries are that the affected firm can control the bulk of its costs, can make decisions with little remaining governmental oversight, and can use high-powered performance pay incentive systems to encourage profit maximization. In addition, it is assumed that regulatory barriers will eventually disappear, allowing for open markets and free competition.

For the United States Postal Service a number of these assumptions do not hold. The Postal Service is labor rather than capital intensive, it does

* The authors appreciate helpful comments from Don Develin, Andy German, John Leeth, Maura Robinson, and Ed Ward, and computational assistance from Timothy Gill.

DOT variables are grouped into the following categories measuring occupational skills and working conditions: training variables; aptitude factors; worker function scales; environmental conditions; and physical demands (see Table 1). Expanding the standard CPS specification to include the DOT addresses the legitimate concern that in CPS-only wage studies schooling and other available variables do not account fully for skills or compensating differentials associated with working conditions. Moreover, the DOT allows one to control directly for job skills, rather than experimenting with rent-related variables (e.g., union status and firm size) that are shaky proxies for skill.

Although it is important to control for job working conditions, neither the magnitude nor signs of these variables can be determined a priori since they depend on the marginal valuations of job attributes based on worker demand and employer supply. If tastes are sufficiently heterogeneous and workers sort on the basis of job attributes, compensating differentials will be small. Coefficients on individual DOT variables are not likely to provide precise estimates of compensating differentials since there is a high degree of collinearity among the variables and working condition variables may in part reflect unmeasured worker skills and income effects (Hwang, et al., 1992). That being said, descriptive evidence on the means of the DOT variables provides information on how job analysts rate postal occupations as compared to private sector occupations. Table 1 provides the means of the DOT variables for union postal workers and private sector workers, excluding professional, technical, and managerial occupations. Postal clerk and carrier occupations require lower levels of training and skill than do private sector occupations, on average. Required training time to achieve occupational proficiency is lower in postal than in nonpostal jobs, and aptitude ratings indicate required levels of verbal, numerical, and spatial aptitudes are lower than the average among private sector occupations. The DOT evaluates postal occupations as requiring a higher level of clerical aptitude than nonpostal occupations.

✓*Premium Estimates*. Postal premium estimates from the CPS and a survey of new hires are summarized in Table 2. The estimate of the bargaining unit postal wage premium from the CPS-only model for 1998 is .213 log points, a 23.7% wage advantage for postal relative to private sector non-postal workers with similar characteristics.[14] The CPS premium

[14] Log differentials are converted to approximate percentage differentials by 100[exp(D)-1], where D is the log differential. "Premium" estimates presented to postal arbitration panels have been stated using the *postal* rather than private wage base. The CPS-only premium using the postal base is 19.2% (i.e., -.213 converted to a percentage), representing how much less private sector workers are paid than comparable union postal workers or, alternatively, the percentage decrease in postal wages that would eliminate the differential.

estimate includes the adjustment for tenure and shift work, which reduced the log differential from .296 to .213. The wage premium calculated for *all* postal workers (78.5% coded union and the remainder nonunion) is moderately lower – .182 log points or 20.0%. The lower premium reflects the fact that non-bargaining unit workers do not receive wage premiums as large as do bargaining unit workers.

Table 2: Postal Log Wage Premium Estimates

	Log Differential	Postal Sample Size	Non-postal Sample Size
Wage Level Regression Estimates (1998):			
CPS-only:			
All Bargaining Unit	.213	575	37,786
CPS-DOT:			
All Bargaining Unit	.309	575	37,786
Postal Clerks	.294	208	37,786
Postal Carriers	.354	229	37,786
New Hire Survey Mean Log Wage Changes (1997-98):			
All Bargaining Unit	.306	1890	–
Postal Clerks	.327	914	–
Postal Carriers	.300	691	–
Mail Handlers	.223	284	–

The CPS-DOT analysis controls for occupational differences in required skills and working conditions. The postal wage premium is larger using the CPS-DOT specification than the 23.7% wage premium obtained using the CPS-only specification. To illustrate how the job variables work, we first enter the DOT skill-related variables, which causes the postal wage differential to rise substantially, from .213 to .351 log points. This reflects the positive impact of job skills on wages and the DOT's assessment that postal crafts require lower levels of skill than the average private sector occupation. When we add DOT working condition variables, the wage premium is lowered modestly, from .351 to .309 log points (a 36.2% premium). This change reflects the small labor market rewards associated with most occupational working conditions, coupled with modest differences between postal and non-postal occupations in the level of work disamenities. The DOT estimate of a 36.2% premium strongly suggests that the CPS wage differential, absent control for job skill and working conditions, understates the magnitude of the postal wage premium.

QUESTIONS FOR THE RECORD FROM DAVID M. WALKER
SUBMITTED BY SENATORS THOMPSON AND AKAKA

Questions for the Record From Senator Fred Thompson

1. **In your testimony before the House in April, you noted that the USPS has had periodic conflicts with some of its key stakeholders, including postal unions and the Rate Commission. Have these conflicts contributed to the current financial situation?**

We have reported on the longstanding adversarial labor-management relations at the U.S. Postal Service (USPS) since the mid-1970s. Our past reports have found that postal workplace and labor-management relations problems had generally contributed to a sometimes contentious work environment and lower productivity, notably in mail processing and letter delivery operations. Poor labor-management relations have been exemplified by a large backlog of numerous unresolved grievances. We have reported that the parties could not agree on common approaches for addressing the problems, which prevented them from sustaining the intended benefits of specific improvement efforts.

Also, throughout the history of postal rate cases, USPS and the Postal Rate Commission (PRC) have had disagreements, such as the disagreement in the most recent rate case that took nearly 16 months to resolve. USPS filed for a rate increase on January 12, 2000. In its recommended decision, issued November 13, 2001, the PRC reduced the size of the contingency[1] and made other changes to reduce proposed rates. On January 7, 2001, USPS put the PRC-recommended rates into effect while it asked the PRC to reconsider its decision. USPS and the PRC continued to disagree about the size of the contingency, and on May 7, 2001, the USPS Board of Governors voted unanimously to modify the PRC's decision and implement higher postal rates. These rates were put into effect on July 1. USPS has estimated that the decision by the PRC to not recommend the full rate increase requested by USPS will lower its total revenues by $390 million in fiscal year 2001.

2. **You further noted that the Rate Commission and the Postal Service have had longstanding disagreements concerning pricing decisions. In what ways could the Rate Commission and the Postal Service have a more cooperative relationship?**

For much of the last 3 decades, the relationship between the PRC and USPS has been adversarial, despite the recognition by both parties that a more cooperative relationship was needed. For example, the 1992 report of the joint task force of the PRC and USPS concluded that what was needed was "a recognition by both the PRC and the Postal Service that continued communication between them, and a cooperative approach to resolving issues, serves the public better than excessive concern for individual agency prerogatives." The joint task force observed that "Policy differences over certain aspects

[1]In identifying potential categories of total estimated costs of USPS recoverable through postal rates and fees, such as operating expenses and various financial accounts, section 3621 of title 39 explicitly includes "a reasonable provision for contingencies" without further description or explanation.

Enclosure

of the recent [1990] omnibus rate case [that was implemented in February 1991] have created an impression of severely strained relations between the [Postal Board of] Governors and the Commissioners. The issue in danger of being obscured, in our opinion, is that ongoing interaction between the two bodies – apart from major rate and classification proceedings – has, in reality, been minimal in the years since reorganization. Various pronouncements that have captured the public's attention, therefore, may be less symptomatic of strain than of the virtual absence of interagency communication. . . The key to improved relations between the two bodies charged with responsibility over postal matters rests in the assumption by the Governors and the Commissioners of direct responsibility for establishing and fostering new lines of communication fully within the letter and spirit of the ex parte restrictions." Nearly a decade after the joint task force report, some progress has been made, but new lines of communication continue to be needed.

For example, in 1997, USPS and the PRC agreed to have a contractor review the quality of data used for rate making and to identify opportunities to improve the completeness and accuracy of this data, recognizing both valid needs for such data and resource constraints. The parties worked constructively together in joint meetings with the contractor, A.T. Kearney, discussing the issues involved and options for improvement. The report on the study was issued in April 1999 and provided a number of recommendations for improvements to USPS' data collection and analysis systems used for ratemaking. However, key recommendations remain unresolved. One set of recommendations was to update data on letter carrier costs based on special studies that were conducted in the 1980s. In the 2000 rate case, USPS proposed updating these special studies with data already collected for another purpose, but this approach was rejected by the PRC. As a result, as in the 1997 rate case, "[The] basic data on which city delivery carrier cost attribution must rely come from obsolete special studies that no longer conform to current delivery operations or the current state of analysis." Thus, continued joint efforts to improve the quality of ratemaking data would be beneficial.

Questions for the Record From Senator Daniel K. Akaka

1. **The financial accountability of the Postal Service has been called into question time and again by the GAO. Why is there an apparent disconnect between what appears to be a very thorough process established by the Board of Governors' Audit Committee and your testimony?**

The financial information available to the Board of Governors differs from that available to the general public. The Board of Governors works with USPS management to make key decisions regarding USPS' financial situation, including decisions related to raising postal rates. In that regard, the Board has access to more detailed information about USPS' budget, forecast, and performance expectations than does the general public. It was not clear to many stakeholders why USPS' financial situation deteriorated so quickly during this fiscal year as there was limited public information to explain the dramatic changes in USPS' financial situation. We believe that USPS' recent action to post a quarterly financial report on its web site with financial results and outlook, accompanied

by explanations for expected changes will help improve its accountability to Congress and the public.

2. **From PMG Henderson's testimony, it appears that the Postal Service will work with GAO in developing a quarterly financial report that details current and projected financial goals. It also appears from your written statement that USPS lacks a comprehensive plan. For an operation as important to the public as the Postal Service, any incremental increase or decrease in revenue has a tremendous impact on USPS' ability to carry out its mission—the timely delivery of the mail. Why do you believe the Postal Service has had such a difficult time obtaining a clear picture of its costs and revenues?**

We have not reviewed the reliability of USPS' revenue and expense projections–both of which should be based on USPS' best estimates for what would likely occur in the future, including the effects of any possible economic downturns. We recognize that concerns have been raised about these projections because of the changes that were made during fiscal year 2001, such as judgmental adjustments to USPS' revenue forecasts. At the same time, because USPS' projected deficit for fiscal year 2001 is relatively small compared to USPS' total revenues and expenses, a precise bottom line projection is difficult to make in that changes in revenues or expenses can have a disproportionate effect on this figure. We are planning to review projections from USPS' forecasts as part of our ongoing review of its financial situation and outlook, including whether different approaches to projecting and budgeting would yield better estimates.

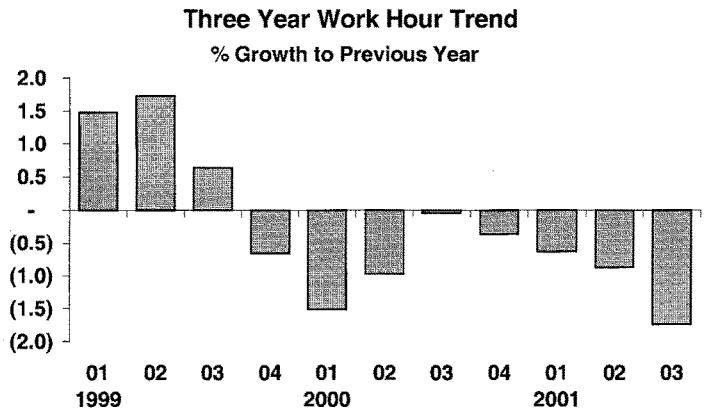
QUESTIONS SUBMITTED TO POSTMASTER GENERAL HENDERSON
IN FOLLOW-UP TO THE SENATE OVERSIGHT HEARING ON MAY 15, 2001

Questions for the record submitted by Senator Cochran

1. Last November, the Postal Service projected a deficit of $480 million for the current fiscal year. In February, the Service changed its projected deficit to $2 billion to $3 billion. Now the Service is saying the deficit will be in the $1.6 billion to $2.4 billion range.

a. The Service's poor track record in forecasting mail volumes and revenues has had real world consequences for ratepayers. For example, in the first quarter of this fiscal year, the Service had excess costs because it has based its staffing and resource allocations on overly optimistic forecasts of First-Class Mail and Priority Mail volumes that failed to materialize. Doesn't the Service need to do a better job forecasting its mail volumes and revenues?

The Postal Service operations team and financial analysts monitor volume and revenue more frequently than quarterly. The field has access to local daily, weekly and accounting period volume data and production statistics. National volume data and revenue data at all levels of the organization are produced each accounting period. These data permit resource plans to be reassessed and emphasis shifted as the year progresses based on actual workload. The Postal Service has responded extremely well to shifts in workload as indicated by the fact that it is exceeding productivity targets. Quarter 1 Total Factor Productivity was 2.5 percent compared to a plan of 2.0 percent. Year-to-date actual Total Factor Productivity is 2.0 percent, which exceeds the planned TFP of 1.3 percent. While we strive to improve the quality of our forecasts, these results mean that forecast errors have not prevented highly favorable results in terms of matching resources to actual workload. This is demonstrated in the following chart that reflects workhour trends by Quarter since 1999. Keep in mind that over that time period, the Postal Service delivered 7.9 billion additional pieces of mail to 3.3 million additional delivery points with about 20,000 fewer employees.



b. What is the Service doing to improve the quality of these crucial forecasts?

Recognizing that forecasting is part art and part science, the Postal Service is committed to doing everything it reasonably can do to improve the quality of its revenue and volume forecasts. The Postal Service engages is an active research program on the demand for its services and continuously updates forecasts to reflect that research and the latest information on the marketplace and the state of the economy.

2. In March, the Postal Service announced a freeze on capital commitments that affects more than 800 facility projects this fiscal year and 1,000 projects next year. Why was this freeze imposed?

The freeze on capital commitments was imposed because of unanticipated revenue shortfalls resulting in reduced cash available to meet current obligations.

a. Will the freeze delay sorely needed capital improvements and the associated efficiency gains that help keep postal rates down? In other words, is freezing capital commitments a band-aid that will be penny-wise today and pound-foolish tomorrow?

The freeze on capital commitments, including over 800 facility projects, was not initiated to generate savings to improve financial results. As stated above, this was a fiscally responsive action, taken to ensure that cash is available to meet current obligations. Essentially, all new facilities projects were frozen. However, when funding becomes available, we will proceed with projects that we can afford and either produce productivity gains or maintain our infrastructure. We will also proceed with selected investments related to the health and safety of our employees and customers, all legal requirements and other emergencies.

b. How long will the freeze on capital investment last?

We expect that the freeze on new contracts will continue at least through this FY2002. We will continue to plan for additional projects that produce productivity gains and contract for them when funding is available.

c. Will the Service's financial difficulties result in a huge backlog of needed capital investment in post offices and postal facilities?

There will be a backlog. The size and the impact of that backlog will depend on the length of the freeze. The action to freeze new capital commitments was taken with the recognition that, in the long run, this could have a negative impact. Given our financial situation there was no choice. Continuing to proceed with additional investments when the funding was not going to be available was not an option. We will monitor the impact of delaying major investments and will take action to sustain operations until funding is available to make improvements.

d. Last October, the Service's Strategic Plan called for $3.7 billion in capital commitments in fiscal year 2002. However, the Service is now planning only about $1.7 billion in capital commitments in fiscal year 2002. What is being cut out?

Final numbers for FY 2002 are still being developed and will not be approved by the Board until September of this year. Estimates by category of investment will not be available until mid-summer, as priorities are determined.

Due to the limited availability of funding for new capital commitments for 2002 we plan to wait as long as possible to make the final decisions on investment priorities. When compared to our original plan, we expect that the FY 2002 plan will be substantially reduced across all categories. As stated above, we will proceed with projects that either produce productivity gains or maintain our infrastructure. We will also proceed with selected investments related to the health and safety of our employees and customers, all legal requirements and other emergencies. However, at this time, the exact funding by category is not known.

e. The Service's capital assets include more than 38,000 post offices, stations, and branches. How much capital investment should be made annually just to maintain this retail network?

Over the past 20 years, annual capital commitments for building improvements to maintain all of our facilities have averaged $337 million. In that 20-year period, the annual capital commitments ranged from a low of $69 million in FY 1982 to a high of $719 million in FY 1999.

3. In April, the Postal Service announced that it was studying the impacts of reducing delivery from 6 to 5 days a week. What other alternatives are being considered?

The study has not been completed. The Board of Governors (BOG) requested a report within 90 days. Findings will be presented to the BOG on July 9.

- a. Is the Postal Service unable to find more efficiencies within its current structure instead of restricting service?

The Postal Service is studying facility consolidation and network efficiencies for sorting and transporting mail. A number of procedures have been implemented that have contributed positively to the bottom line over the last few years.

- b. What impact would cutting Saturday delivery have on customer satisfaction?

As a result of the Board of Governors request, postal management created a task force to study the impact of reducing delivery from six to five days a week. As part of a comprehensive review, the task force is attempting to assess customer reaction to a reduction in delivery days. This assessment includes reactions from business mailers, major mailers, and household recipients.

- c. Is the Service studying whether it could save the same amount of money by expanding self-service options at post offices? If so, is the Service taking aggressive action to maximize savings in its retail network?

The current self-service options at post offices include vending machines and scales. Vending machines will be added based on field office reviews; however, no new purchases are planned. Existing inventory will be redistributed to meet customer requirements.

We are continuously researching ways to expand its self-service options to meet customer requirements.

We are continuously looking for the most efficient manner to serve customer needs throughout our entire network and provide universal service.

- d. As the Service has recognized, there are wide variations in quality, costs, and productivity across its system of 350 major mail-processing facilities. Why is this the case? Doesn't this mean that the Service could save billions by improving the productivity of its least efficient facilities?

The Postal Service recognizes the wide variation in cost, quality, and productivity throughout its processing and delivery operations around the country. There are many reasons for this, all of which have been addressed in years past. Processing and delivery sites differ greatly with mail mix, transportation issues, volumes differential, and facility layout.

This past year, the Postal Service achieved huge productivity gains over previous years, mainly due to the organization's stand on Breakthrough Productivity Initiatives (BPI). This BPI effort touches every part of the organization and enforces changes in work habits and past practices.

4. The Postal Service has spent much time and effort on finding new sources of revenue. However, concerns have been raised that the Service's new products and services may not achieve the targeted results for this fiscal year.

a. How much revenue is the Service counting on from its new products and services, such as e-commerce services?

The FY 2001 target revenue was projected at $4.9 million. This is an extremely small proportion of the overall Postal Service revenue.

The FY 2001 plan is $300 million for revenue initiatives. Many of the Postal Service's revenue producing products and services are relatively new, with most being less than a year old. As experience with these ventures progresses, it has become clear that the Business Plans were overly aggressive. The individual 2001 plans for these initiatives were:

- **Retail - $100 million plan**
- **Media Ventures - $100 million plan**
- **eCommerce - $100 million plan**

a. Is the Service on track to achieve this target?

No.

b. How many people – both employees and contractors – does the agency have working on electronic products and services?

Within the Corporate & Business Development group, there are approximately 58 employees working on product planning, development, implementation, and management of our Internet Channel. Additionally there are IT resources that support these initiatives and the Internet Channel. As with any large enterprise IT resources are not normally dedicated directly to specific programs but are assigned to broader infrastructure roles.

As for contractors, due to the varying workload this number fluctuates constantly making it impossible to give an accurate number.

c. When the Postal Service partners with independent contractors to offer electronic products and services – such as electronic BillPay, PC Postage, NetPost, CardStore, and Electronic Certified Mail – does the Postal Service receive any revenue other than postage for items physically mailed? Conversely, has the Postal Service provided a guarantee of revenue or a minimum volume of business to any partner or licensee in providing electronic products or services?

Yes, the Postal Service does receive other revenue besides postage for the following products: eBillPay, NetPost Mailing Online, NetPost CardStore, NetPost Certified and NetPost Certified Mail.

The Postal Service has on occasion included revenue guarantees in contracts with suppliers and in strategic alliances with our business partners. A revenue guarantee may be established for a strategic alliance when the revenue potential of the alliance is reasonably quantifiable but its full potential over the term of the alliance is unknown. The objective is to minimize capital investment while maximizing cash flow.

In a purchasing scenario, the revenue guarantee is used in much the same way as we would use a guaranteed minimum in an indefinite delivery contract. In this case, the objective is to guarantee the Postal Service a ready source of supply for critical requirements while minimizing the supplier's risk.

Three programs have included revenue guarantees: eBillPay, Mail Transportation Equipment Service Centers (MTESCs) and, Mailing Online. The programs are in varied stages of contract performance. In the last five years, the Postal Service has paid approximately $2.6 million in guaranteed revenues under the MTESCs contracts. Mailing Online and eBillPay provide revenue guarantees of $325,000 and $1 million, respectively, for the current year. Through May 2001, no revenue guarantee payments have been made under either of these programs.

d. Last September, GAO made several recommendations to address a number of inconsistencies and problems it found with information the Service provided on its e-commerce initiatives. What actions has the Service taken to respond to GAO's recommendations?

We have developed a formal, structured financial performance statement (similar to profit and loss statements in the private sector) that we require quarterly for each eCommerce initiative. Beginning with the first quarter of this fiscal year, we implemented a more comprehensive report to ensure that we could track and assess each initiative's revenue and expenses accurately and uniformly. We think that our eCommerce financial performance statement, which we will continue to refine, fully responds to GAO's recommendation for more complete and accurate financial information for our eCommerce initiatives.

5. The Postal Service has experienced long-standing labor management problems that have, among other things, hindered productivity improvement efforts. To what extent has the Service worked with the unions to develop innovative productivity improvements for mail processing and delivery operations, and what successes, if any, has the Service had?

The Postal Service has made efforts in past negotiations to involve the unions in improving productivity. As recently as the 2000 round of national negotiations, the Postal Service proposed a variable pay or pay-for-performance concept to the American Postal Workers Union (APWU), the National Postal Mail Handlers Union, and the National Rural Letter Carriers' Association. In proposing a pay-for-performance compensation system, the Postal Service indicated that the existing bargaining unit pay system did not link compensation to the success and well being of the Postal Service. The Postal Service further explained to these unions during 2000 negotiations that a pay-for-performance system should reward performance, increase productivity, and recognize employee contributions to achieving the goals of the Postal Service. None of the three unions expressed any interest in exploring such a pay system.

During 1998 national negotiations the Postal Service proposed variable pay or pay-for-performance to the American Postal Workers Union, the National Association of Letter Carriers, and the National Postal Mail Handlers Union. None of these 3 unions expressed any interest in exploring this type of pay system.

During 1990 negotiations, the Postal Service proposed the Striving for Excellence Together Program (SET) to each of its 4 major unions, the American Postal Workers Union (APWU), the National Association of Letter Carriers (NALC), the National Postal Mail Handlers Union (Mail Handlers), and the National Rural Letter Carriers' Association. The SET Program was designed to improve financial and customer service performance through cash incentives for achieving goals related to changes in the ratio of revenue to paid hours and changes in the Customer Satisfaction Index. Both the Mail Handlers and the Rural Carriers participated in the SET Program. Cash payments were paid to employees for 4 years. The APWU and the NALC chose not to participate in the SET Program.

6. Although the Postal Service has historically had difficulty improving productivity, we understand it has recently instituted a new breakthrough productivity initiative. Could you give us an overview of your new initiative and describe the key steps or actions the Service is taking to ensure the success of this initiative?

The Breakthrough Productivity Initiative is a comprehensive multi-functional effort to drive approximately $4 billion in costs out of the organization by FY 2006. To accomplish this, BPI is focused on:

- **Improving productivity in mail processing, delivery, and customer service operations**
- **Reducing overhead and administrative costs**
- **Reducing the amount of transportation used and the cost of that transportation**
- **Reducing the cost of all goods and services purchased as well as reducing consumption**
- **Redesigning networks to optimize efficiency and service performance.**

The Postal Service has established a high-level steering committee to monitor implementation and results to ensure the success of the initiative

The Integrated Resource Management (IRM) is one of the new BPI initiatives that was launched in FY 2000 to 18 pilot sites. In general terms, IRM is an effort to reduce the sick leave rate, improve customer service, increase efficiency and reduce costs. Specifically, it provides for centralized coordination of attendance control and consistent Family Medical Leave Act (FMLA) decisions, while reducing paperwork for the line supervisors, using a software application called Resource Management Database. Another key component is the leadership training to enhance management and communication skills for managers/supervisors. Based on favorable results attained by the pilot, this initiative is currently under expansion service-wide. This expansion will impact 400,000 employees by the end of fiscal year 2001 and will increase operational efficiency for the Postal Service.

Key steps or actions taken to ensure success of IRM:

- **Joint partnership and cooperation between Human Resources and Operations**
- **Senior management commitment, involvement and support**
- **Frequent communications (briefings, publications, telecons, etc.) established from the top down**
- **Close coordination between headquarters, area, and the field offices**
- **Headquarters and area monitoring of site implementation plans and performance**
- **Resource Management Database (RMD) software application enhancements**

7. Last year, the Service called for achieving $1 billion in savings from its "breakthrough productivity" initiatives. What results has the Service achieved to date? When will the Service achieve and sustain truly "breakthrough" increases in its productivity, given the difficulty that the Service has had in this area?

In FY 2000 we achieved a total savings of $1.6 billion. Approximately $500 million of this was from returns on investments in capital equipment and the remaining $1.1 billion was from pure productivity improvement. In FY 2000 our total factor productivity increase was 2.4% which was twelve times the average annual increase for the previous ten-year period.

Postal Service cost reduction initiatives for FY 2001 fall into two broad categories:

Savings from investments in capital equipment and our Breakthrough Productivity Initiative.

Major capital equipment investments include:

Flat Sorting Machines, Delivery Bar Code Sorters, Remote Bar Code Sorting Programs, Identification Code Sort, Tray Management System, Auto Air Assignment and Semi Auto Scan Where You Band, Robotics, MTE Service Centers and Small Parcel and Bundle Sorters.

These programs and others total $454 million for FY 2001.

Breakthrough Productivity Initiatives for FY 2001 include: Operations Initiatives, Transportation, Supply Chain Management, and Overhead Reductions.

These programs totaled $756 million for FY 2001. The combined total is approximately $1.2 billion for FY 2001. Through the end of May, the Service has achieved a savings of $962 million as measured by Total Factor Productivity (TFP). With 4 months remaining in the fiscal year we are confident of achieving the full savings this fiscal year.

Relative to the Integrated Resource Management (IRM) effort, a combined savings of approximately $23 million has been achieved for all the site locations that have implemented the Resource Management process, including the 18 pilot sites that have been in full operation since the first of this fiscal year. It is anticipated that the Postal Service will realize a projected cost savings of $54 million by the end of this fiscal year.

We feel the combined total for these two years meets the definition of breakthrough productivity.

8. The Service set "breakthrough productivity" targets of only 0.7 percent for this fiscal year. How can the service call this "breakthrough productivity"? Given the Service's current condition, isn't much more progress needed?

The FY 2001 Total Factor Productivity (TFP) target was set at 0.7%. This is a corporate level target and incorporates labor costs, materials costs and capital investments. Many of these costs are fixed and offer no opportunity for productivity improvements. For example, we must deliver to every household every day and are adding 1.7 million new delivery points to our expanding delivery network this year, even as fuel costs continue to escalate and drive up the cost of delivery. We have to pay for an existing facility infrastructure and a network of Postal Vehicles. Retiree annuity and health benefits costs and workers' compensation costs are considerable.

A more illustrative indicator of our productivity efforts may be found in considering our total targeted cost reductions of $1.2 billion as a percentage of our field operating expenses of $54.3 billion. That percentage would be 2.2 percent, a clear indication of "breakthrough productivity".

9. A reduction in revenue per piece of mail due to the increased use of discounts based on worksharing agreements is frequently cited as a reason for the current losses of the Postal Service. Does workshared mail have a lower net income per piece than non-workshared mail? If not, how can worksharing discounts contribute to losses?

A change in the mix of mail by classification or product type can reduce revenue and affect the bottom line. As an example, Standard mail, while profitable, is less profitable than First-Class Mail. Currently, Standard Mail is growing more than anticipated and First-Class Mail is growing less than expected. This change in mix affects the bottom line of the Postal Service.

In addition, workshare mail volume is growing more than expected and non-workshare mail is growing less than anticipated. The revenue consequences are felt immediately as more discounted mail means less revenue.

9a. Does the Postal Service ever conduct studies to determine if the estimated cost savings from workshared mail are actually being realized?

The Postal Service does reexamine its cost savings estimates for worksharing discounts, particularly when these discounts are revisited during a rate case. Postal Service rate case submissions include extensive testimony and studies projecting costs avoided by worksharing, as a basis for setting worksharing discounts. These studies determine the operational benefit of the different types of worksharing and then quantify the cost savings arising from these benefits.

It is difficult to determine if the savings accorded worksharing were actually achieved at a particular moment in time for a particular facility. The Postal Service allocates its budget to post offices on the basis of the workload content of the post office's mail. The mix of mail, along with the amount of worksharing involved, determine the workload content of the mail and indicate resources required. By allocating resources according to the workload content of the mail, the savings from worksharing are realized.

9b. Have you developed any kind of restructuring plan that will enable you to shed all unnecessary costs from operations as the mix of mail changes with more workshared mail in the mailstream?

Yes, we address changes in the mail mix due to work sharing when we develop our operating budgets. For each fiscal year the change in mix of the mail volume due to the adoption of worksharing by our customers is forecasted. The change in the level of work that results from this change in the mail mix is factored into our operating budgets and work hours will be reduced if there is less work content. After the period, if there is a difference between the actual and forecasted change, adjustments are made to the operating budgets to reflect the actual change in the workload.

ANTITRUST CONCERNS

1. Isn't Federal Express a direct competitor of the U.S. Postal Service for overnight and priority mail delivery?

The Postal Service's overnight mail product lacks many of the features and capabilities that Federal Express offers and is not truly competitive with Federal Express. Similarly, while Federal Express offers a deferred delivery product, that is not a significant competitor for the Postal Service's Priority Mail. These were important considerations that led the Postal Service to conclude that collaboration with Federal Express would not harm competition but rather would be pro-competitive and beneficial to the Postal Service and postal customers.

2. Isn't the combined market share of Federal Express and the U.S. Postal Service for priority mail and express mail well over 60% of the entire market?

We understand that for the year 2000, FedEx had 42.5 percent of industry revenues just for overnight air letters and packages.

3. Isn't it true that the contract between Federal Express and the U.S. Postal Service will cause numerous aircraft companies that currently serve the Postal Service to idle their *727s* and DC-9s?

The Postal Service currently has contracts in place with several air transportation companies. The Postal Service has no information about whether these companies have been successful in attracting additional business for the period during which the Postal Service contracts will expire. Further, the Postal Service does not have any information about how these companies plan to allocate their assets in the future.

4. What other uses are there for those aircraft? Have you considered the issues?

Much as a corporation's first obligation is to its shareholders, the Postal Service's primary obligation is to the American people. The Postal Service is required to provide the nation with effective and economical service. In order to accomplish this goal, our primary task has been to identify the air transportation company that will provide us with the best service at the best price. We considered whether this agreement would benefit the American public; we did not consider how private businesses might employ their assets.

5. How many jobs will be lost at the airline companies that had previously served you?

The Postal Service has no information about the effect of this contract on airline companies' employment outlook.

6. Doesn't the seven-year term of the contract make it very difficult for existing aircraft companies who are hurt by the contract to be in a position to bid when the contract is renewed?

Not at all. At the time the present contract expires, the Postal Service will once again be interested in identifying potential air transportation providers with strong customer bases independent of the Postal Service. As the economy expands over the next seven years, it is difficult to predict which companies will be successful in building the customer bases that will make them attractive as possible air transportation providers for the Postal Service.

7. Is it possible that although this contract might save the Postal Service money in the short run, it will cost the Postal Service in the long run as a result of decreased competition among air transport companies that will result from this contract?

While it is true that this is a possibility, we do not believe that it is a likely outcome.

8. Would you have any objection to a review of the contract by the Antitrust Division? Did you consult with the Antitrust Division prior to signing the contract?

The agreement between FedEx and the Postal Service was submitted to the Department of Justice's (DOJ) Antitrust Section for review shortly after it was executed on January 10, 2001 Representatives from the Postal Service and FedEx have been diligently working with DOJ representatives to assist them in their understanding and review of the agreement. To date, DOJ has not issued an opinion in the matter.

9. Would you have any objection to a review of the contract on antitrust and other grounds by the GAO?

The Postal Service would not object to a GAO review.

Other Concerns

1. The Post Office and FedEx began talks this past August or September. FedEx will not begin performing under the Contract until August 2001. FedEx needed this time to expand certain routes and hire additional pilots. FedEx has also been given $100 million to assist in start-up costs.

a. Why was FedEx given all exclusive one-year opportunity (and $100 million) to conform to the Post Office's requirements?

FedEx was not given a one-year opportunity to conform to the Postal Service's requirements. The Postal Service did not conclude the transportation agreement with FedEx until January 10, 2001. The contract will become effective approximately seven-and-a-half months later, on August 27, 2001. While it is true that FedEx will use this time to hire and train pilots, the Postal Service also needs this period to structure and test the integration of its transportation requirements with the FedEx system. On a daily basis, the Postal Service operates air transportation facilities from approximately eighty-one major cities. Matching the transportation requirements of these facilities with the FedEx system requires a high degree of planning and coordination.

b. In the history of Postal contract awards, has any other company been given this type of advance payment?

In those instances where the Postal Service has determined it to be in its best interest, we have paid one-time reimbursement for start-up of expenses that are not part of the ongoing operation. The payment to Federal Express was made to provide reimbursement for a negotiated portion of the cost of starting up the contract with the Postal Service. Previous to the arrangement with Federal Express, the Postal Service made other one-time payments to other suppliers so that those suppliers would not embed such costs in their base contract price and thereby receive economic adjustments for the duration of the contract. It is to the Postal Service's financial advantage to pay some fair portion of non-recurring costs as a one-time up front payment.

The bulk of the start-up payment to Federal Express was for hiring and training employees to operate the contract. As mentioned above, the payment of this cost was a one-time payment consistent with past practice. Examples of other one-time payments for start-up costs include the following:

- **Payments made to Emery for painting aircraft (ANET-99-01)**
- **Payments made to Emery for Hushkitting aircraft (Muffler) (ANET-99-01)**
- **Payments made to Emery for Stage Three Avionics (ANET-99-01)**
- **Payments made to train pilots for selected point-to-point operations (ANET-99-01)**
- **Payments made in 1991 to Zantop for pilot training and positioning of aircraft**
- **Payments made to Emery for start-up for Priority Mail Processing Center (102590-97-B-1460)**

The start-up payments to Federal Express were included in all analyses of the proposed contract prior to the Postal Service conclusion that the contract would result in significant cost savings over our current dedicated networks.

c. Why not give six or ten companies the opportunity to conform and see who will save you the most money?

Based upon a very thorough analysis of the air transportation market conducted by PricewaterhouseCoopers (PwC), the Postal Service does not believe that there are six or ten companies capable of meeting the Postal Service's requirements. That same analysis indicated that only FedEx is capable of meeting the Postal Service's transportation needs. Key requirements include that the air transport contractor be financially stable, have what is known as a "shared network" and be able to meet Postal Service transportation requirements on a nationwide basis.

A shared network is essentially one which transports mail from a number of customers, thereby providing services at a cheaper cost since all the customers support a portion of the contractor's overhead costs. Currently, the Postal Service utilizes a series of "dedicated networks." These dedicated networks transport only Postal Service products. Thus, the contractors' overhead costs are not apportioned to any other customers, and consequently, are higher than those associated with a shared network, where a number of customers share overhead costs.

A company with a robust shared network is also likely to be financially stable, as a number of customers contribute to its financial well-being.

The ability to provide transportation service on a nationwide basis is of critical importance. Our experience has proven that dealing with a number of different carriers causes inefficiencies often associated with fragmented networks: communication problems, tracking difficulties and problems arising from transferring shipments between different carriers.

This is a tough bill to fill. The Postal Service, in concert with PwC, determined that allowing a number of companies the opportunity to conform would not result in a better deal for the American public. On the contrary, such an approach would delay needed improvements in the Nation's mail system.

2. When the Contract expires in 2008, and the Post Office looks for competitive bids, or even options other than FedEx, what other companies will be available to compete for the contract?

The Postal Service does not know how many air carriers will exist in 2008 when the transportation agreement expires and how many of those will meet Postal Service mail transportation requirements as of that date. As was the case with the current contract with FedEx, the Postal Service will assess its transportation needs in relation to available resources in 2008 and decide what course to pursue.

a. Given the limited number of entities, what will be the disincentive for, FedEx to increase sharply the price of future work?

The current contract was negotiated on a sole source basis because the Postal Service concluded that FedEx was the only air transport contractor that could meet its needs. Notwithstanding the fact that FedEx was aware during these negotiations that it was the only contractor being considered, the resulting negotiated price will result in significant cost savings. Assuming, for the sake of discussion, that there will be a limited number of air transport contractors available in 2008, there is no reason to conclude that a reasonable price cannot be negotiated.

3. Currently, the Post Office is served by a network of regional carriers. The Post Office has indicated that the FedEx contract is a preferable arrangement because it will be a uniform system. The Contract, however does not prohibit FedEx from use of subcontractors. Do you know the extent to which FedEx plans on using subcontractors?

We do not know the extent to which FedEx plans, if at all, to subcontract work required under the transportation agreement. FedEx is obligated to transport mail throughout its entire network regardless of whether subcontractors are used. The contract does, however, limit FedEx to subcontracting no more than 30% of its work under this contract.

4. As the recent litigation has made clear, the Post Office did not open this Contract for competitive bidding, nor did it invite any other entity to the negotiating table. While the Court of Claims has decided that this did not violate the Post Office's internal regulations, our concern is not so much with the Post Office's internal regulations, as with the sheer size and import of the contract. Shouldn't the single biggest contract in the history of the Post Office have been opened up to competitive bidding?

The Postal Service recognized that the competitive bidding process did not lend itself to the very complex task of linking its transportation system, which is one of the largest in the world, with that of a contractor. Instead, the Postal Service approached this matter much as a private sector business would: It determined which carrier was the most likely to meet its needs, and subsequently engaged in extensive negotiations to ensure that the contract was commercially reasonable. The Postal Service drew upon its own knowledge and experience with the air transportation industry, and on a market study performed by PricewaterhouseCoopers (PwC). In preparing its market study PWC relied upon publicly available information. The study exhaustively analyzed the capabilities of many air transportation contractors prior to deciding that FedEx was the only one that met the Postal Service's requirements.

5. Did the Post Office do any analysis of the effect of this Contract on the number of planes available for the CRAF program?

A CRAF analysis was not performed as part of the agreement with Federal Express. We do not anticipate, however, that the agreement will have any detrimental effect on the CRAF program. We also note, in this connection, that Federal Express has demonstrated and continues to have a strong commitment to the CRAF program."

a. What happens when there is a war or national emergency? There aren't an infinite number of planes available, and there will be fewer when the existing regional air carriers go out of business.

It would be speculative to assume that there would not be sufficient numbers of aircraft available to participate in the CRAF program in the event of an emergency because of the transportation agreement between FedEx and the Postal Service.

b. Won't it be a choice between delivering supplies to soldiers and delivering the mail?

See response in 5(a)

6. Has the Post Office determined the parameters under which the Postal Inspectors will have access to FedEx facilities?

The Inspection Service is currently working with FedEx security to clearly define a number of issues involving investigative protocol, access to facilities and personnel records, personnel screening processes, and mail security. FedEx recognizes the investigative and security jurisdiction of the Inspection Service related to the US Mail, and has been very cooperative.

a. Does FedEx plan on modifying its security in light of the presence of postal inspectors?

FedEx is in the process of modifying it hiring practices to ensure all new hires brought on after contract commencement complete the necessary documentation to apply for USPS non-sensitive security clearances allowing access to the US Mail. Reviews of FedEx's compliance with the required background checks will be conducted. FedEx facility security will be evaluated by the Inspection Service on a site-by-site basis once mail is being processed through FedEx facilities.

b. Does FedEx get to let its customers know that, unlike all of its other competitors, FedEx is specially policed by the Postal Inspectors?

We are not aware of any plans FedEx has to inform its customers of the contract with the USPS. However, Postal Inspectors will have investigative and security responsibility over the US Mail while in FedEx possession. The Inspection Service will not be investigating violations unless the US Mail is involved.

7. Has the Post Office determined whether this arrangement gives FedEx monopoly power?

The Postal Service considered whether the agreements with Federal Express would affect competition and determined that there would not be an adverse effect on competition. Federal Express will not as a result of the agreements have a monopoly in any relevant market.

a. What kind of market share will FedEx have for overnight letter?

The Postal Service does not compute market shares. Studies that the Postal Service has commissioned estimate that, for the year 2000, FedEx had 44.4% of industry revenues for overnight air letters and packages.

b. Does FedEx's affiliation with the Post Office shelter it from antitrust laws?

The Postal Service does not believe that any of its agreements with FedEx would violate the antitrust laws even if those laws applied.

8. A number of regional carriers, most prominently, Emery, have stated that they could perform the services required under the FedEx contract for less money. Given that cost savings was one of the justifications of the contract with FedEx, shouldn't you allow other carriers an opportunity to bid on the work now?

No. Emery made the same argument before the Court of Federal Claims. The Court found Emery's argument unconvincing, in part, because Emery failed to prove that it could deliver comparable service at a better price.

a. Would you be willing to look at other carriers' bids?

The Postal Service does not believe that other financially stable carriers possess the ability to provide a shared network, with sufficient reach and resources, to meet the Postal Service's needs. The Postal Service arrived at this determination after exhaustive research performed jointly with PwC. The Court of Federal Claims held that the Postal Service acted reasonably in adopting this approach. For these reasons, we do not believe it would be useful to open a competitive bidding process.

9. Would you agree that many risks associated with mail distribution have lessened -diversified - by use of several different regional networks?

There are risks associated with any program for air transportation. For instance, if one of the dedicated network carriers were to experience catastrophic performance failure of some sort, the impact to remaining network carriers would be significant.

What if FedEx's pilots go on strike? What if there is a disaster: a flood, a terrorist attack that closes down Memphis? Has the Post Office determined a procedure for handling such a disaster?

Yes. (a) In the event there were isolated performance failures of short duration, the Postal Service would repossess any tendered mail and combine that mail with the other untendered mail for that market(s). After determining the most efficient alternate transport method, that mail would either be trucked or placed on commercial carriers until the performance failure was abated.

(b) In the event of a more widespread, long-term performance failure (to include a total performance failure), the Postal Service would be required to make two determinations. First, on an interim basis, a determination of the most efficient alternate transport method would be made. Pursuant to that determination, mail would either be trucked or placed on commercial air carriers.

10. FedEx is a publicly traded company. As such, it is subject to the same market risks as all companies; bankruptcy, hostile takeovers, fraud, corruption, change in board control, failure of financial products, merger expenses, over-leveraging and other similar events. Given that FedEx will be the sole company in which the Post Office can rely, how has the Post Office analyzed and prepared for those risks?

See the response to question 9 above.

11. Article 8.5 of the FedEx contract provides certain undisclosed limits on the amounts of mail FedEx is obligated to deliver under the contract. These limits operate as a ceiling on the Post Office's air capacity. This seems to give FedEx a great deal of control over an entity it listed as its competitor in its annual report. What safeguards does the Post Office have in place to ensure it can deliver all the mail it is given, not just the mail FedEx agrees to deliver?

The Agreement contains provisions establishing minimum mail volumes that FedEx is obligated to transport. There is no ceiling on the maximum amount of mail volume FedEx can transport. The parties can mutually agree that FedEx will transport any amount of mail above the guaranteed minimum volume established in the contract.

Prior to entering into negotiations with FedEx the Postal Service reviewed its mail volume data and determined the amount of lift capacity it needed to have included in the contract. The minimum amounts to which the parties agreed provide the lift necessary to meet the needs of the Postal Service. Further, the contract provides the Postal Service with an option (to be exercised in its sole discretion) to increase the minimum amount of lift capacity FedEx is obligated to transport. This will enable the Postal Service the opportunity to address future increases in mail volume.

The Postal Service never intended for all of any class of mail volume to be transported under the FedEx contract. Commercial air carriers, highway contractors and other means of transportation will still be used.

12. Article 8.4 of the FedEx contract requires the Post Office and FedEx to share information.

a. Has this been analyzed from an antitrust perspective?

The Postal Service analyzed all aspects of its agreements with FedEx from an antitrust perspective.

b. Does the Post Office have any concerns sharing information with the "competition?"

The Transportation Agreement between FedEx and the Postal Service contemplates collaboration that will enable the Postal Service to provide reliable and improved service. To the extent that it is necessary to provide FedEx with information about the Postal Service's needs to implement that agreement, which will inure to the benefit of the Postal Service and competition. The Postal Service believes that the information to be shared with FedEx will not impede competition but rather will facilitate more effective competition.

13. (Specifically to Postmaster General Henderson] Your term is coming to a close. Why did you choose a time at the end of your tenure to enter into a seven-year agreement with FedEx?

Mr. Henderson was firmly convinced that the agreement with FedEx would contribute substantially to the Postal Service's economic viability. Consequently, he saw no reason to postpone the agreement. Mr. Henderson did not choose to wait until the end of his tenure as Postmaster General; the opportunity presented itself at that time and he felt that his duty to the Postal Service obligated him to explore the opportunity fully.

a. Why didn't you give your successor the option to decide?

As stated above, Mr. Henderson believes that this contract ensures the continued strength of the Postal Service. Additionally, Mr. Henderson believes that any Postmaster General, confronted with our present economic position, would see the obvious benefits inherent in this contract and act accordingly.

b. Why didn't you make the term of the agreement shorter?

One of our principal aims in concluding this agreement was to lock down our transportation costs for the foreseeable future. That is, our costs in this area have been escalating in a manner that has been difficult to control. In concluding a long-term agreement, we brought predictability and economy to an area that had been troublesome.

Questions submitted for the Record by Senator Fred Thompson

1. The Office of Inspector General of the Postal Service reported $1.4 billion in fraud, waste, abuse, and mismanagement. Reports like this could not come at a worse time. What are you doing to address these reports in order to assure the public and Congress that the USPS is taking all possible steps to address its financial situation?

The Inspector General has reported that her office has identified $1.4 billion in Postal Service funds that can be captured as savings. The OIG has identified these monetary savings as "questioned costs" and planned expenditures for which the IG "recommended funds put to better use."

In fact, the total of $1.4 billion, claimed as savings identified by the IG, includes $1.017 billion in planned program funds that the Postal Service itself identified as expenditures unwarranted by the course of business development and which the Postal Service itself captured as savings. These funds include $962 million for Corporate Call Center expansion and operations over a multi-year period, and $55 million that the IG states can be saved from Rail Detention Costs. The Postal Service estimates savings from Rail Detention Costs at $35 million, rather than the $55 million stated by the OIG, bringing the estimated total savings initiated by management in these two programs to $997 million.

In addition to that $997 million in real savings that were identified and captured by postal management, the IG identifies another $271.02 million as savings under specific audit recommendations that Postal Service management believes cannot or should not be realized, either partially or at all. Among these recommended savings, the Postal Service estimates that:

- **Only $110 million, rather than the $192 million reported by the IG, can be gained as savings from Rail Detention Costs, and from Emergency and Extra Trip Expenditures on Highway Routes. The IG has overestimated these savings by $82 million;**
- **No savings can be realized, rather than the $28,848 million identified by the IG as savings, under the Southwest Area Expenditures For Extra Highway Trips Using Leased Equipment and the Commercial Air Carrier Performance for Ground Handling audits; and,**
- **The amount of potential savings is unknown, rather than the $50,177 million that the IG has identified in the Extra Trip Expenditures Within the Mid-Atlantic Audit and the Dedicated Christmas Air Network - Phase 1 Audit.**

  The savings identified in all of these audits, the derivation of these savings, and the Postal Service's management of cost reduction in these programs, are discussed below:

- **OIG Audit DA-AR-99-003 -- Corporate Call Management. The $962 million in savings realized from the Corporate Call Centers, and claimed as savings under this audit, were monies planned to fund five toll-free customer service call centers over a seven-year period. The funds were never expended. The ongoing management review of the call center program, conducted under the auspices of the Board of Governors, evidenced that the program could service customer needs with three fewer call centers than had been planned and management decided against expansion of the program. This is an example of routine, sound and responsible management of the Postal Service. Yet, in testimony before Congress, the Inspector General stated that, "In one review, we identified almost $1 billion in cost avoidances over a seven-year period for a project to establish a nationwide toll-free response line."**

We are pleased that the Independent Office of the Inspector General concurred with management's findings regarding the call center program. We are pleased also that the OIG found that achieving $1 billion in costs avoidances over a 7-year period to be an accomplishment worthy of attention.

- OIG Audit, TR-AR-99-001 -- Savings in Rail Detention Costs. The OIG asserted that $55 million in savings could be achieved with recommended actions under this program. The Postal Service estimates instead that $35 million will be avoided over the five-year program. Importantly, this is another instance in which actual cost avoidance has been achieved by direct management initiative and action, rather than as a result of an OIG audit. Management eliminated the area plans for detention charges starting in FY 2000. FY 2001 actual cost avoidance is estimated to be approximately $4 million. Additionally, we are negotiating with the carriers in this program to give credit for vans returned early and to eliminate detention itself almost entirely.

- OIG Audit TR-AR-005 -- Southwest Area Expenditures For Extra Highway Trips Using Leased Equipment. The IG Audit ascribed a one-time amount of $848,000 as savings to be achieved under this program by collecting from contractors with whom the Postal Service is in a dispute resolution process. In fact, no amount is likely to be collected.

- OIG Audit TR-AR-006 -- Commercial Air Carrier Performance for Ground Handling. Management did not agree to the OIG finding of $28 million in possible savings to be achieved over five years, under this program. USPS pays an overall system rate for these services and the work performed by the carrier is more at some sites than the estimated average on which the system rate is based. The OIG report refers only to sites where work performed is less than the estimated average.

- OIG Audit TR-AR-00-009 -- Extra trip expenditures within the Mid-Atlantic. It cannot be determined if the OIG's recommended five-year savings of $2.477 million can be realized.

- OIG Audit TR-AR-00-011 -- Dedicated Christmas Air Network-Phase 1. Based on the Christmas 1999 mailing season, the IG's Report suggests routing mail to arrive after the critical entry times of the offices (planning to fail) and thereby saving $47.7 million in one year. Management did not agree to this recommendation and instead agreed to extend surface reach. The Christmas 2002 mailing plans are now being developed and potential savings are unknown.

- OIG Audit TR-AR-003 -- Emergency and Extra Trip Expenditures on Highway Routes. The OIG Report stated that a five-year savings of $137 million was to be reached over five years under this cost avoidance recommendation. The report used 17% as the potential savings in cost per mile; the actual rate of reduction is 10%. In the first year, $15 million in costs were avoided and, with that as a basis, we project that a potential of $75 million in savings is possible over five years.

- OIG Audit TR-AR-99-001 -- Savings in Rail Detention Costs. As detailed above, the OIG audit asserted that $55 million in savings could be achieved with this program, but we estimate instead that $35 million will be avoided over the five-year program.

The actual savings of at least $997 million achieved under these initiatives are significant and the Postal Service pursues savings where possible. Still, there is always room for improvement and the Postal Service is actively involved in responding to concerns of the OIG, GAO, and to independent auditor issues that warrant follow-up, add value and are cost-effective. This process is ongoing and is wholly consistent with our dedication to managing this public resource in the public interest.

Perhaps this is among the characteristics of Postal Management that led *Government Executive* magazine, in its recent grading of seven federal agencies, to rank the Postal Service with "As" in the three areas of financial management it reviewed: Managing For Results; Financial Management; And, Physical Assets Management. This independent study, funded by the Pew Charitable Trust, graded the overall management of the Postal Service as, "A-."

Indisputably, the Postal Service could do a better job of assuring the public that we are managing their business in their interest. Pursuant to the recommendations of the Comptroller General, the Postal Service will be posting quarterly reports on its financial status and business progress on the Postal Service web site, usps.com.

a. In light of the projected deficit, are you planning to make bonus, or "EVA payments," this year? Are bonus payments tied in anyway to overall Service financial performance?

The Economic Value Added (EVA) Pay for Performance Program is not a bonus program. It is a group pay-for-performance program, which covers over 84,000 non-bargaining employees. This program takes a portion of an employee's pay and makes it contingent upon the attainment of certain performance measures. The program has pre-established, measurable performance indicators, and a sophisticated formula for providing incentive credits based on organizational success. The program is not an after-the-fact "bonus" program that provides subjective evaluations of the eligibility and size of bonus payments. The Postal Service's EVA Pay for Performance Program is a proven driver of organizational success and is a key component of the total compensation plan for managerial and non-bargaining employees. Certain employees gave up overtime payments in order to participate in the EVA program. None of the participants receives cost of living (COLA) pay increases.

The potential incentive under the EVA Pay for Performance Program is determined by actual EVA, calculated at the end of each year. By design, the EVA Pay for Performance Program provides both positive and negative incentives. Accordingly, when EVA is zero, no incentive is earned; in fact when EVA is negative an employee's pay for performance reserve account is reduced.

The EVA Pay for Performance Program is funded by financial performance as measured by Economic Value Added (EVA). EVA is a comprehensive measure of revenues less expenses less the capital commitment needed to grow our business. If economic value is added to the Postal Service as measured by EVA, then incentive credits are provided if organizational units within the Postal Service achieve a balanced scorecard of performance targets. One of the balanced measures is our Voice of the Business, which has national, area, and performance cluster productivity targets that roll-up to the national.

Since we have had six years of success in adding value to the Postal Service through the EVA Pay for Performance Program, employees will receive payouts from their reserve accounts under the formula established in 1995.

3. The USPS Comprehensive Statement shows that workers compensation costs rose more than $300 million in FY 2000 to $925 million. What efforts are you taking to control these costs?

For a number of years we have had in place a safety program that has resulted in an OSHA Injury/Illness rate that is significantly lower than those of our private sector competitors. The Accounting Period (AP) 9, year-to-date national rate is 7.86 compared to 7.95 for this period last year. Using the latest published data (1999) from the Department of Labor, manufacturing's OSHA Total Injury/Illness rate was 9.20 and trucking and warehousing (our competition) was at 8.70.

In Fiscal year 2001, the Postal Service made the OSHA Total Injury/Illness rate one of the important compensible indicators of our Pay for Performance Program for management. We established a target of a 3 percent reduction on last year's end of year performance for headquarters, the areas, and performance cluster management teams.

Every performance cluster and major facility that was not achieving their OSHA Injury/Illness target by Accounting Period 7 of this fiscal year has provided headquarters with action plans to attain this year and next year's goals. All other performance clusters that were achieving their target are to provide headquarters with their action plans by the close of Postal Quarter III. These plans will focus improvement for this year and ensure that we will begin next fiscal year with a continuous focus on reducing accident/injuries.

Since AP 7 our performance has improved from only six of our 11 areas and 42 of our performance clusters achieving their targets to nine of the 11 areas and 50 of the performance clusters achieving their targets at the close of AP 9.

We are also developing a five-year plan of projected performance reduction for the OSHA Injury/Illness rate and the associated costs.

In addition to accident prevention measures we have taking steps, within our authority, to control our workers' compensation costs:

- **The Postal Service has aggressive programs to provide "limited-duty" assignments to employees recovering from job-related medical conditions and rehabilitation assignments for employees with permanent job-related medical restrictions.**
- **The Postal Inspection Service and the Office of Inspector General continues to aggressively pursue workers' compensation fraud committed by employees and medical providers.**
- **We recently entered into an agreement with one of the largest Preferred Provider Organizations (PPO) to utilize their provider network to reduce our medical costs below what OWCP's medical fee schedule would allow. The pilot program was initiated during March 2001, and will be expanded rapidly if cost savings are confirmed.**

However, overall management of the workers' compensation program resides with the Department of Labor. Other than initial controversion, the Postal Service has no authority to contest workers' compensation claims filed by employees and has no input into the claims adjudication process. Under current OWCP rules, Postal Service Injury Compensation staff cannot even telephone a claimant's doctor to discuss a claimant's medical condition or describe the job requirements of available limited-duty positions. This has hampered our ability to design job offers tailored to the claimant's condition and substantially impacted our rehabilitation efforts in recent years. We believe that this plays a partial role in the dramatic increase in our workers' compensation expense seen in FY2000 and 2001.

4. The Postal Service, like the rest of the Federal Government will be experiencing increasing retirements over the next several years.

a. What actions has management taken to plan for this?

Approximately 39 percent of our EAS (non-bargaining) workforce will be eligible to retire through year 2005. This means that over 32,000 EAS employees could potentially leave the Postal Service based on retirement eligibility alone. The Postal Service has developed both executive and managerial core competencies as the fundamental standard for our organization in order to determine the required skills needed to fill these potential future positions. We have initiated several new leadership programs in addition to our existing employee leadership and skill-based developmental opportunities. In addition, for employees just beginning a career in management, we offer the Associate Supervisor Program and the Career Management Program. Core technical programs are in place to cover building systems, vehicle maintenance and supervision, automation equipment, material handling, vending equipment, maintenance management, and environmental and safety issues. When the Postal Service purchases new mail processing equipment, vending and revenue protection software, and new vehicles or enhances current machines or processes, specific training courses are developed and delivered to the appropriate maintenance personnel, operators, and supervisors. This year the Processing and Distribution Management Program was rolled out to build technical competence for employees on succession plans for the position of plant manager.

b. What impact will increasing retirements have on Postal Service budgets?

Postal Service budget estimates explicitly incorporate the expense impacts of an accelerated tempo of retirements. Our most recent President's Budget submission, prepared and submitted in December 2000, indicates as much. Our two major expense accounts for postal retirees are those for annuitants' COLAs principal and for annuitants' health benefits premiums. Both of these accounts experience high growth in the near-term, reflecting increases in the number of retirees and their survivors that are included in the underlying estimates.

c. These retirements will also increase your payments for retiree health benefits. What are your projections for these costs?

Per the President's Budget submitted last December, the estimated FY 2002 annuitants' health benefits expense is about $1 billion (or an 11.5% increase from the FY 2001 estimate). The FY 2003 expense estimate is slightly over $1.1 billion.

5. I understand that more than 700 postal employees attended the recent Postal Forum in Orlando, Florida in March. Please provide a complete record of the costs the Service incurred in funding the participation of these employees in this event, including costs incurred for travel, food, and lodging.

a. Further, please provide any other costs the Service incurred attributable to its participation in this event.

Seven-hundred-fifty-six Postal employees attended the Postal Forum in Orlando, Florida in March. In addition, 790 Postal employees attended the Postal Forum in Anaheim, California in September 2000. Costs for both these events are included in our Postal Fiscal Year 2001 (September 9, 2000 through September 7, 2001). Costs associated with these events are charged at a national and local level. For both of these two events, costs charged nationally through Accounting Period 10 amount to $1,011,854 in exhibit costs and the costs for administrative staff employees attending these Forums. Local charged costs include costs of travel, meals and lodging, as well as registration fees, for Postal employees participating in the Forum and a separate account number is used for these charges. For these two events, $1,683,017 has been charged using this account number. However, it is possible that some costs were not charged to this account number.

We believe these expenditures have proved to be consistent good investments for the Postal Service. The training and education sessions and the workshops offered at the Forum have helped Postal Service customers take advantage of worksharing and automation programs. These programs have helped lower Postal Service operating costs and improve service performance. The Forum has also identified new business opportunities for the Postal Service. Through the Orlando Forum alone, Postal Service sales representatives identified over $40 million in new business opportunities for the Postal Service.

Questions submitted for the Record by Senator Robert F. Bennett

1. The USPS has been criticized in the past for not aggressively capturing the savings from the introduction of new technology and automation into mail processing. What steps is the USPS taking to ensure that an aggressive program to quantify and capture all savings that result from the introduction of new automation systems is installed?

Automation is producing savings and cost avoidances greater than original projections. Since 1987 we have invested $5.4 billion in letter mail automation projects and through 2000 we have achieved approximately $19 billion in savings/cost avoidances against original projections of about $18 billion. Operating budgets in the areas impacted by operations have been reduced and will continue to be reduced. Productivity is at record levels. Career complement has been reduced by over 21,000 since its peak in 1999. Potential automation systems, as do all our cost saving measures go through a rigorous review before they are implemented. Automation investments go through a capital investment analysis to quantify the benefits and determine the rate of return. Resulting reductions in labor and other expenses are agreed upon by field personnel and built into the operating budget to assist in the capture of the projected savings.

2. Is it possible that new technology is not getting into the USPS in a timely fashion and if so, why not?

Given the scope of our services and operations, the Postal Service has many opportunities to apply technology to improve operations. Postal management must ensure that every dollar is spent wisely and in a manner that most benefits the public. As a result, new technology investments must compete for funding with all other aspects of operating the nation's mail system. In addition, the Postal Service relies on its vendors to provide technology research and development. This combination of factors results in a more conservative approach to technology development than might be found in an organization which maintains a substantial funding for research and development. This approach means that while in some areas we are among the world leaders in the application of technology to postal operations, in others we have chosen not to be on the cutting edge of new technology.

Our technology investments continue to yield significant benefits to our customers, in the form of reduced costs of postal operations, improved service, and providing value-added services for customers.

3. How long will it be before significant USPS cost reductions are realized?

See the answer to number 1 above. Cost reductions are being realized. When this year concludes, we expect that savings, as measured by Total Factor Productivity, will be approximately $1.2 billion.

Questions submitted for the Record by Senator Pete V. Domenici

1. It is my understanding that the Postal Service intends to cut operating and capital costs over the next five years in an attempt to improve its financial situation. However, I don't believe we've seen the plan for how this will be achieved. Has a cost-cutting strategy been developed and can you share some of it with the Committee today?

Yes, we have developed a plan referred to as "Bold Actions" that we have shared with our Board of Governors. This is a plan for reducing growth in our personnel and non-personnel expenses. It includes reduction in the growth of personnel expenses through deployment of capital, productivity improvements, processing network adjustments, attendance management and administrative staff reductions. It also includes reduction in the growth of non-personnel expenses through reduction in the growth of transportation costs, reduction in administrative costs and improvement in safety performance.

2. The capital cost cutting policy has halted the production of the much-needed processing plant in Albuquerque, New Mexico. Are these cuts across the board or is there a selection process for determining which capital projects will proceed and which ones will not?

The freeze on capital commitments, including over 800 facility projects, was not initiated to generate savings to improve financial results. This was a fiscally responsive action, taken to ensure that cash is available to meet current obligations. Essentially, all new facilities projects were frozen. However, when funding becomes available, we will proceed with projects that can be afforded and either produce productivity gains or maintain our infrastructure. We will also proceed with selected investments related to the health and safety of our employees and customers, all legal requirements and other emergencies.

3. On April 25, 2001, I sent Postmaster General Henderson a letter that outlined a possible money-saving measure. In the letter, I noted that according to a Price Waterhouse Coopers study, the amount of undeliverable-as-addressed mail handled by the USPS costs the USPS approximately $1.5 billion annually. As the letter stated, Mr. Paul Greene of Pitney Bowes Software Systems, identified a number of areas that technology can be utilized to reduce these costs.

a. Has the Postal Service taken any steps to implement this technology?

Siemens has a U.S. Patent for the interception and handling of UAA mail. As a result, other companies are excluded from offering technological solutions that would infringe on that patent.

b. What measures are being taken to reduce the undeliverable-as-addressed mail problem?

We are currently testing a system called Postal Address Redirection Service offered by Siemens that will intercept UAA mail the first time the mail piece is run on our letter automation equipment. The mail piece will then be relabeled with the new address and entered back into our automated letter mail stream. This will significantly reduce the cost of processing UAA mail in the Postal Service.

We have also provided our major mailers with a system called "Fastforward". This system provides updates to major mailing services' directories to reduce UAA mail before it is generated.

Another improvement is allowing customers to fill out their change of address forms over the Internet. This allows customers to update our national directory directly, thereby reducing processing requirements.

We have also begun to electronically notify mailers who request address correction when a customer moves. This is a big cost savings over hard copy notification.

4. The Postal Service is losing money on many of its non-postal products, particularly its e-commerce products. Can you tell the Committee if the Postal Service plans on discontinuing any of these services or whether steps are being taken to improve their profitability?

Profitability is a primary goal across our eCommerce products. Like any new product introduction, each one must respond to a market need and each takes some amount of time to gain "traction" in the marketplace.

Reporting procedures have been developed to monitor performance and progress on a weekly or monthly basis. In addition, we have established the Corporate and Business Development Advisory Committee, consisting of several senior executives, which also monitors the performance of eCommerce products and services. This committee serves as a decision-making body for discontinuing products or services that do not gain "traction" in the marketplace.

5. More than a year ago, the residents of Chaparral, New Mexico in Dona Ana County, applied for their own ZIP Code. Although they were approved through the Western Regional stage of the process, they were denied at the next level. This is a rapidly growing area, and I would ask you to please re-examine their application.

The ZIP Code package for Chaparral, New Mexico, was reviewed in March 2000. At that time the information provided from the Area and District did not meet the minimal requirements for a new ZIP Code as outlined in the Postal Operations Manual. The growth projections did not indicate there would be a need for a new ZIP Code for Chaparral in the next 20 years.

The package predicts a growth rate of 6 percent per year over the five-year period from 1999 to 2004. Actual figures indicate that the total growth in the ZIP Code has been only 2.9% (248 deliveries) over the 18 months since the package was created. That results in a 2 percent real annual growth rate rather than the 6 percent predicted in the package. There has been one auxiliary rural route (R005) added since the package was created, bringing the total number of routes to eleven. ZIP+4 sector usage has increased from 77 to 79. The sector growth could necessitate a ZIP Code split within 20 years, but this issue could be eliminated if the AMS office recoded the PO Boxes. This could free as many as 51 sectors for future use, providing more than enough for predicted growth.

ZIP Codes are only established when we are able to identify operational needs, substantial savings, or service improvements.

This particular request appears to be based on the community's interest in establishing a 5-digit ZIP Code for community identity. Had the community of Chaparral not requested their own ZIP Code, it is very doubtful that the package would have been submitted.

As a valued, long-term corporate asset of the Postal Service, 5-digit ZIP Codes can only be authorized in the following instances:

- When there is an operational need that supports our mission of providing the best possible service for our customers.
- When an existing ZIP Code structure impedes quality service
- When there is an opportunity to significantly reduce our distribution and delivery costs.

The request for ZIP Code 88081 meets none of these criteria.

QUESTIONS SUBMITTED TO GOVERNOR RIDER IN FOLLOW-UP TO THE SENATE OVERSIGHT HEARING ON MAY 15, 2001

Questions for the record submitted by Senator Thad Cochran

1. What prevents the Service from cutting its costs more rapidly to respond to changing conditions?

The Postal Service is committed to reducing expense growth, but there are limitations to what can be achieved by cost containment. The cost of labor is currently growing at a rate greater than the rate of inflation and this limits the Postal Service's ability to reduce expenditures.

For the years 2001 through 2003, the Postal Service has planned for $ 2.5 billion in cost savings. Achievement of these savings will lead to an unprecedented string of cost savings. But, because of the level of cost inflation experienced by the Postal Service and because of less revenue growth resulting from the current soft economy, those savings will not eliminate losses or the need for another rate filing. The Postal Service's finances have been negatively affected by surging fuel, utility and health care benefit expenses; by high labor COLA's; by a labor arbitration award that advanced most city carriers a grade in their pay scale; and, by the loss of cash that was forgone due to the inadequate rate recommendations of the Postal Rate Commission.

In addition, the Postal Service needs to fund network growth in new deliveries on city and rural routes that is equivalent annually to adding a city the size of Chicago to the network. This network expansion must be funded whether or not we receive increased revenue from mail volume growth. Due to weakening volume and revenue growth, inflationary cost pressures mentioned above, and the impact of funding network growth, an additional rate increase is required to re-balance revenues and expenses.

2. In March, I received a letter from you and the other members of the Postal Board of Governors, detailing your current financial situation and urging Congress to begin work on postal reform. Could you tell me specifically what you want to see in a reform package?

A meaningful postal reform proposal should include the following elements:

- **Pricing flexibility, including a faster rate setting process, the ability to customize services for major customers, and freedom to price non-monopoly products.**
- **Product flexibility, including the ability to introduce new products without resorting to overly cumbersome administrative proceedings.**
- **Labor and operations flexibility, including replacement or repair of the binding arbitration process.**

3. Given the financial losses the Service is anticipating for both this fiscal year and the next, what are the Board's top priorities for improving the Service's short-term and long-term financial position?

Our short-term strategy involves controlling costs through aggressive cost containment programs. We are committed to $2.5 billion in cost reductions over the three-year period from FY 2001 through FY 2003. The Board has also ordered a capital freeze on sustaining and infrastructure projects. This means that the Postal Service has suspended committing capital for new facilities. The freeze is a very short-term solution. Facilities

are needed in the long-term to respond to network growth, to maintain service and to provide space to deploy automated mail-sorting equipment. Cost containment and the capital freeze will conserve cash and help to reduce, but not will eliminate, our financial losses. A rate increase will be needed to earn a net income.

As for the long-term, the Postal Service supports the course of action recommended by the Comptroller General in testimony before the Senate Governmental Affairs Committee and the House Committee on Government Reform:

1. **The Postal Service should develop a comprehensive plan in conjunction with Congress and its other key stakeholders, such as the postal unions and management associations, customers, and the Postal Rate Commission, that would identify the administrative and legislative actions needed to address the Service's financial, operational and human capital challenges and that would establish a timeframe and specify key milestones for achieving desired results.**

2. **The Postal Service should provide summary financial reports to the Congress and the public on a quarterly basis, to provide all interested parties with an understanding of the Postal Service's financial conditions and its future outlook; and,**

3. **The Postal Service should work with the GAO and Congress "to identify and analyze possible improvement options" -- including options developed by other countries for the transformation of their postal services -- for addressing the Service's short-term and long-range challenges."**

The Board will lead the Postal Service effort in this process. In furtherance of these recognized objectives, the Board has exercised its role by acting on its primary responsibilities in recent weeks. First, we selected a Postmaster General who will provide leadership and managerial strength to the Postal Service. We feel that Jack Potter is particularly well suited to lead the Postal Service through this transitional phase. Second, the Governors met our fiduciary duties to the Postal Service by acting responsibly in the ratemaking process when we voted unanimously to modify the rates recommended by the Postal Rate Commission. The third of these responsibilities is to guide the development of policy and business strategy for the Postal Service. Pursuant to that, the Governors have advised Congress of the critical parameters of postal reform.

4. Over the last ten or so years, the Postal Service has invested billions of dollars in new automation.

a. What types of savings did the agency originally expect to incur; and what has been the actual return on this tremendous investment?

Automation is producing savings and cost avoidances greater than original projections. Since 1987, we have invested $5.4 billion in letter mail automation projects and through 2000 we have achieved approximately $19 billion in savings/cost avoidance against original projections of about $18 billion. Operating budgets in the areas impacted by operations have been reduced and will continue to be reduced. Productivity is at record levels. Career complement has been reduced by over 21,000 since its peak in 1999.

b. Has the Service ever conducted any long-term analysis of the overall effect of its automation program on the unit costs of letters, flats, and parcels? Would you agree that something like this might prove to be worthwhile?

Yes, as shown above we do perform ongoing analyses and also conduct special studies when warranted. These are usually in the form of performance models and interim- or after- cost studies. We believe they are worthwhile but are after the fact and costly to perform, therefore are used sparingly. We prefer to use ongoing measures of productivity performance such as Total Factor Productivity. Our in-office cost systems also provide long term analysis and this data is used in ratemaking processes.

Questions for the record submitted by Senator Fred Thompson

1. The Board has asked management to review a number of cost cutting initiatives, including a reduction from six to five days a week for postal deliveries and consolidating post offices. What is the status of this study?

The study is not complete yet. The Board of Governors requested a report back within 90 days. Management will present that report on July 9.

Questions for the record submitted by Senator Daniel Akaka

1. The Board of Governors is charged with representing the interests of all Americans. As such the Board reviews the practices and policies of the Postal Service and is involved with the long-range planning of the Service. One area that has received attention recently is what the Postal Service calls "media ventures." The Service expects to receive $100 million this year, in part, from selling display ads on postal trucks and allowing Kmart to advertise the return of its "blue light specials" on the Postal Service's Internet web site. While I understand the desire to increase revenues, I question the effect that such ventures have on the Postal Service's reputation, one of its most valuable assets. Our nation trusts the Postal Service with its messages and merchandise and has done so for over two hundred years. I would like to know what discussion, if any, has there been among the Board of Governors on the effects of such activities on the reputation of the Postal Service, and does the Board approve implementing these activities?

The Postal Ad Network initiative formerly known as "Media Ventures" focuses on selling advertising space on Postal Services' varied assets. This initiative will allow the Postal Service to maximize the value of our powerful brand and generate additional revenues for the Postal Service.

Last November, the Board of Governors was briefed on the Postal Ad Network initiative. The Postal Ad Network is an extension of other similar efforts like the Postal Service Mover's Guide and Welcome Kit that were established in 1995 and received a significant part of their revenue from private sector advertising. Mover's Guide initiative brought in $29 million and won the prestigious Hammer Award from the Vice President's National Program to Re-invent Government in 1997. The USPS Office of the Inspector General reviewed this program and concluded that the Mover's Guide "inclusion of advertising to reduce costs and potentially create revenue is not a change in mission (for the USPS); it's good business."

Our experience to date has been very favorable with various campaigns (i.e. include Lance Armstrong, AOL and VISA) on Postal Service varied assets. The Lance Armstrong campaign (on Postal Service vehicles and Priority Mail Packages) capitalized on two consecutive victories at the Tour de France, with Lance Armstrong and the USPS Cycling Team. Our advertising campaign "The Ultimate Internet Delivery Vehicle" on Postal Service vehicles with AOL is great example of showcasing the Postal Service and the relationship with the Internet. The VISA campaign on Priority Mail packages promoted the use of their product with the Postal Service. All these examples contributed to building customer equity and enhancing our brand. The Postal Service has also conducted market research with advertisers and consumers to determine the effect of commercial advertising on Postal Service assets with favorable results with both the advertisers and consumers.

In order to ensure that the Postal Service's reputation and brand are not diminished, a Commercial Advertising Policy was developed and implemented. This policy takes the matter of assessing an advertiser's appropriateness and desirability out of the realm of case-by-case judgment and negotiation ensuring that advertising is tasteful. The Postal Service will exercise control over what commercial advertising we accept by application of a set of published standards that align with our corporate objectives. The Postal Service will not accept advertising that is indecent, or obscene, a product or service that competes with a Postal product or service, or is political or religious in nature.

Given the policy and procedures implemented, we believe the program can be managed in a thoughtful manner and offer a positive way of generating new revenues for the Postal Service while protecting the integrity of it's brand.

2. The Board of Governors has asked the Postal Service to study the impact of reducing delivery from six to five days a week. How does the Service determine what impact cutting Saturday delivery may have on customer satisfaction?

As a result of the Board of Governors request, postal management created a task force to study the impact of reducing delivery from six to five days a week. As part of a comprehensive review, the task force is attempting to assess customer reaction to a reduction in delivery days. This assessment includes reactions from small business mailers, major mailers, and household recipients.

3. The Postal Service estimates that every time gasoline prices go up a penny, it costs the Postal Service $5 million. Does the Postal Service have figures on what impact there is when postal rates go up?

The Postal Service does analyze the impact of postal rate changes, as indicated by the following explanation of postal price impacts on volumes and revenues.

Price Elasticities for Postal Products

How much volume does the Postal Service lose when it increases prices and how much volume does the Postal Service gain by cutting prices? The Postal Service requires accurate answers to these questions to make correct pricing decisions. The price elasticity of a product or service is the key analytical tool used in those considerations. A product's price elasticity measures by what percent its volume demanded varies for a percentage price change.

The table below displays various non-postal product price elasticities

PRICE ELASTICITY
Selected Products

	Price Elasticity	How will a 10% Price Cut Affect Volume	How will a 10% Price Cut Affect Revenue
Tobacco	-1.9	19%	7%
Jewelry	-0.7	7%	-4%
Motion Pictures	-3.5	35%	22%
Foreign Travel	-1.8	18%	6%
Electricity			
Composite	-0.8	8%	-3%
Commercial & Residential	-0.7	7%	-4%
Industry	-1.0	10%	-1%
Food	-0.15	1.5%	-8.5%

A technical point to note is that all these elasticities are negative: it is no surprise that people normally buy more at lower prices.

Cutting price increases volume always but increases revenue only sometimes. Take food for example. The elasticity is -. 15; a 10 percent reduction in price causes only a 1.5 percent increase volume increase; but an 8 percent revenue drop. That is because every unit has lower revenue, not just the additional units. Conversely, a 10 percent price increase would cause a 1.5 percent volume decline, but an 8.5 percent revenue increase.

How much is known about the price elasticity of postal products? A great deal is known. Over two decades, the Postal Service has conducted extensive research to determine the impact of prices on our products' volumes and revenues and, as a result, has produced sound price elasticity measures. The research has been subject to scrutiny. It has been continuously extended and improved.

Do all postal products have the same price elasticity? Hardly. Postal services vary in their price responsiveness, which has implications for pricing strategy. First-Class Mail has an average price elasticity of -0.25. A 10 percent price cut would increase First-Class volume by 2.5 percent but would result in a $2.5 billion revenue loss (7.5 percent). Standard enhanced carrier-route has a price elasticity of -0.95, suggesting it is far more sensitive to price changes than standard regular (-0.274.) The following table summarizes the price elasticities for selected postal services:

Types of Mail Service	Price Elasticity	How will a 10% Price Increase Affect Volumes?	How will a 10% Price Increase Affect Revenue?
First-Class	-0.25	-2.5%	7.5%
Periodical Regular Rate	-0.15	-1.5%	8.5%
Priority	-0.82	-8.2%	1.8%
Express	-1.57	-15.7%	-5.7%
Standard Regular	-0.57	-5.7%	4.3%
Standard Enhanced Carrier Route	-0.81	-8.1%	1.9%
Parcel Post	-1.23	-12.3%	-2.3%
Certified	-0.81	-8.1%	1.9%
Money Orders	-0.43	-4.3%	5.7%
	Source: R2000-1		

Almost all postal products are price inelastic: a 1% change in price changes volume by less than 1%. Note the revenue implications: Can the Postal Service increase revenues by decreasing the price? Yes, but only if the price is elastic, meaning that the elasticity is less than - 1. Less than 5% of Postal Service revenues comes from products that are price elastic.

Is price elasticity the only influence on the demand for our products? No. Price increases have a significant impact, but so do many other factors. Postage is only 31% of direct mail costs. Paper prices affect the demand of standard mail. The economy's current weakness is also affecting volume trends.

4. Some industry commentators have said that by raising rates, which drives some customers toward other means of communicating, the Postal Service is putting itself into a "death spiral." It is also believed that the Service's actions threaten to drag its commercial customers into this spiral. Nonprofit mailers and magazine publishers are especially sensitive to increasing rates. For magazines, rate increases drive up magazine subscription rates, which could drive customers away from hard copies of magazines and toward reading material on the Internet. How does the Postal Service analyze the effect rate increases have on each class of mailers and the possible harm that increases have on the retail and commercial customers?

The Postal Service is concerned about the impact of its rate increases and is required not only by law, but by its public service mandate, to consider the impact in developing its rate proposals. We look at the size of the increase, along with the rate of inflation, and recent increases for that class of customer. At the same time, we are required by law to insure that the revenues from each product line are sufficient to cover the associated costs. This requirement drove the recent rate increase for Periodicals. It is worth noting that the previous law governing the setting of nonprofit rates is responsible for much of the volatility seen in those rates. The new law enacted this past year is expected to reduce much of that volatility.

The concern about the impact of the rate increase must be balanced against two factors. First, by law, the Postal Service is a user-funded system. As such, if the costs increase, then the users pay more under this arrangement. At the same time, the Postal Service should pursue opportunities to reduce costs whenever possible to reduce the upward pressure on rates. Our productivity improvements show progress in this area. However, cost cutting must not be done indiscriminately, and must be weighed against the potential reduction in the services our customers expect.

Finally, a couple of items are worth noting. We certainly understand our impact on the magazine industry. However, the Postal Service is not the only factor affecting its customers. Increases in the price paid for paper, reduced advertising revenues due to a slow-down in the economy and general readership trends all play a part in the general health of that industry. This is not to say that the Postal Service is abrogating all responsibility for the health of the publishing or in the nonprofit community. Instead, we are suggesting that as in any area of the economy, generally many factors come in to play.

Please be assured that we understand the negative consequences of rate increases. Our volume forecasts reflect the volume reductions that occur when prices go up. We also recognize the value of having Periodicals as part of the mailstream, and will continue to work with mailers to make using the mail as cost effective as possible.

5. Would you explain the Postal Service's borrowing authority and whether the Board supports borrowing funds in order to sustain financial stability?

Under Title 39, the Postal Service is authorized to issue debt for capital improvements and to defray operating expenses, subject to a total limit of $15 billion. In any fiscal year, the net increase in debt issued for capital improvements shall not exceed $2 billion and the net increase in debt to defray operating expenses shall not exceed $1 billion. Annually, the Board of Governors provides borrowing authorization to management in amounts sufficient to ensure the availability of funds for capital improvements and other essential activities.

The Board of Governors believes that long-run financial stability is best secured through legislative reform. The Board does not believe the Postal Service can achieve or sustain financial stability through borrowing.

6. Would you explain the responsibility of the Board's Audit Committee and describe how the Audit Committee fulfills its oversight responsibilities relating to the Postal Service's financial statements? I would also be interested in learning if there has been a time when the Board questioned financial information provided by the Service?

The Audit and Finance Committee of the Board of Governors recently updated and approved its charter that reflects the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees (Blue Ribbon Committee) recommendations for audit committees of publicly-traded companies. This revision of the existing charter was largely a formality as most of the practices advocated by the Blue Ribbon Committee were already in place at the Postal Service.

The Securities and Exchange Commission, the securities exchanges and the Auditing Standards Board have since adopted the recommendations as rules. The intent of the new rules is that audit committees need to be diligent in their oversight of the financial reporting process. To achieve this objective, audit committees need to work closely with management, internal auditors and independent auditors to promote accurate, high-quality, and timely disclosure of financial and other information to the Board and to stakeholders. Those recommendations establish a code of conduct for independence as well as guidelines for oversight that work to improve accountability for all parties.

The Audit and Finance Committee of the Board of Governors meets on a regular basis with members of management, the independent certified public accounting firm, and the Inspector General to discuss audit and finance-related topics. The Committee meets individually with any of the three entities listed above. In 1999 and 2000, the Committee convened seven times during the course of the calendar year to fulfill its responsibilities. There are seven meetings scheduled for calendar year 2001.

As to the second question, the Committee, as a part of its due diligence, routinely asks questions regarding:

- **The financial, economic and operational drivers of the information,**
- **The assumptions management used, and**
- **The estimations made and changes to those estimates.**

In addition, the committee regularly asks questions regarding major capital expenditures, borrowing authority, product costs and significant contract issues.

The committee recognizes that the financial statements are the responsibility of management. The committee has in the past asked its independent CPA firm about the accuracy and the quality of the assertions made in the financial information. The committee has also asked its independent CPAs about the nature (conservative or aggressive) of the assertions and estimations. The response has historically been that the assertions and estimations are appropriately conservative. The independent CPA firm engaged by the Board of Governors has rendered an unqualified opinion on the financial statements in all but one year since the Postal Reorganization Act.

7. The Postal Service's 2000 Comprehensive Statement notes, and I quote: "With each electronic service initiative, we've sought to provide convenience, high-value Internet based services for our customers..." Would you describe the process by which the Postal Service determines what Internet products its customers, both retail and commercial, want and would you list which Internet services are self-supporting?

While electronic commerce products are developed within our Corporate & Business Development Department, we do not restrict our product ideas only to those conceived in this group. The Postal Service relies on a host of external sources of information to capture ideas that may have merit. Some of these include: market trends analysis, identification of "gaps" in the current product environment, customer focus group research, and leading market research subscription services.
With our own customer segment, we conduct regular customer satisfaction surveys, and we receive continual feedback from our field sales force about products and product needs.

In addition, we have made it easier for customers and employees alike to send us their ideas for products. Directly on www.usps.com, our primary Web site, we have created a template for people to fill out telling us all about their proposed product or service idea. We first scrutinize these ideas through an inter-disciplinary task force. One of our 'gating' mechanisms is to then create a market research plan for the idea or concept. Market research techniques we have used for potential Internet-based products or services include focus group testing, lengthy executive telephone interviews with projected target users, prototyping of the product with usability testing, etc. We couple results of these tests with wider economic forecasting research and market research. In summary, all these activities are designed to identify and validate our customers' needs.

Although all eCommerce initiatives are not yet self-supporting, it should be noted that most of them have been in the market for less than a year. Generally, these initiatives are earning revenue and exhibiting positive growth.

The Strategic Planning Committee of the Board is reviewing the progress of each initiative, including updated business plans, and will see that management's decisions with respect to the initiatives are timely and appropriate.

8. Would you provide us with an example of the costs related to an Internet based initiative from start to implementation?

As products and services are so different, it is difficult to provide an overall picture based on one product. To illustrate how different two initiatives can be, let's compare and contrast two recently launched products, NetPost Mailing Online and NetPost CardStore.

NetPost Mailing online took approximately 3 ½ years to launch. There were considerable costs associated with extensive research, product design, product testing, market testing, software development and classification case litigation.

Since the Mailing Online launch, the Postal Service has developed a presence in the market that has enabled our ability to leverage ourselves and develop partnerships with shared risks and costs. NetPost CardStore was the first of such arrangements. NetPost CardStore was launched in less than 90 days with virtually no expense.

9. In August 2000, the Service received approval from OPM to use voluntary early retirement authority (VERA) in order to reduce the number of career employees. I understand that this authority remains in effect until October 31, 2001. I have several questions relating to this:

a. First, would you define the term work years?

One "work year" is the equivalent hours that a full-time employee works in one year. It has to do with hours that we may eliminate via reduction of overtime or as a result of technology and productivity improvement programs. The term does not necessarily mean that we have eliminated positions and is not necessarily related to VERA.

b. Second, what is the Service's goal or expectation for the VERA program and how successful has it been to date?

VERA is being used to the extent necessary to minimize the number of employees potentially affected by involuntary separation or demotion. Its use is limited to organizational units within the USPS that are downsizing. The Postal Service expects that VERA will reduce the number of involuntary separations by 8 percent. To date, VERA has been offered to 406 employees in impacted positions and 79 of those employees have chosen to use the VERA option.

c. And, lastly, what efforts are being considered or have been undertaken by the USPS to ensure that employee cuts do not affect service?

The Postal Service's use of VERA has been strategic in concept and measured in practice. We offer VERA only within organizational units that are downsizing, and only to employees in impacted positions who are VER eligible. At the present time, employee cuts are limited to employees in administrative positions. This has almost no effect on service. When it comes time to make cuts in distribution operations and delivery operations, those cuts will be guarded. They will be aimed at positions whose workload has diminished because of decreased mail volume due to technology, work consolidation, a soft economy, etc.

10. According to the Postal Service's *2000 Annual Report,* over 50 percent of the liabilities on its balance sheet — approximately $30 billion — is for deferred retirement benefits. This amount represents benefits owed to postal workers and retirees. If the Postal Service were to reach its statutory debt ceiling, how would these benefits be funded?

The $30 billion represents the current value of future obligations to retirees and postal workers covered under the Civil Service Retirement System. The Office of Personnel Management (OPM) administers this program for the federal government. The deferred liability represents the estimated current value of the obligation of the Postal Service to fund the cost of Civil Service Annuities related to pay increases granted by the Postal Service since its inception and the estimated liability for the cost of annuitant COLAs as determined by Congress. In FY 2000, $3.6 billion was paid by the Postal Service on this obligation. As information, it is our understanding that the Postal Service is the only federal agency to pay these costs.

If the Postal Service cash flow were to be insufficient to fund these payments, and the

Postal Service were to reach its statutory debt limit, a choice between paying employee salaries, other expenses, or, the deferred retirement payment to OPM, would have to be made.

11. We've heard that within five years, half of your employees will be eligible for retirement. Does the Service have a strategic plan for reviewing its labor needs so it knows what skills will be needed, types of jobs to be filled, and geographic locations that could be understaffed?

The Postal Service has developed both executive and managerial core competencies as the fundamental standard for our organization and to provide a common and consistent understanding of what skills are needed within internal career development.

We have initiated an EAS Leadership Development process as one strategic initiative designed to address our need for employee retention and leadership development in critical field operations positions.

Approximately 39 percent of our EAS workforce will be eligible to retire through year 2005. This means that over 32,000 EAS employees could potentially leave the Postal Service based on retirement eligibility alone. That doesn't factor in those employees who may leave for reasons other than retirement, such as private sector employment or government positions within other agencies.

The EAS Leadership Development program is designed to create an environment that provides early identification of leadership talent and interest. Responsibility for the process and accountability for the results is shared by the employee and the management team. The program is open to all interested EAS employees and is designed to build a cadre of well-prepared individuals with the leadership and functional skills ready to assume specific identified positions.

The process is managed on a local level through a Performance Cluster Resource Board whose key role is to align the managerial workforce with current business goals and objectives. They identify, by specific job function, those areas where vacancies will exist and/or staffing challenges will occur. They are responsible for identifying strengths and weaknesses on a function-by-function basis, defining the needs for particular positions, and planning how to effectively develop people to meet those needs.

Participation in the EAS Leadership Development process does not guarantee an individual a specific position. It allows the local management team to forecast their operational needs and potential gaps; align those with the competencies necessary for successful job performance in those specific positions; and oversee the development opportunities for talented employees to become better qualified to compete for those eventual vacancies.

New postal employees receive the Orientation for New Employees training program. Following orientation training they are scheduled into training specific for their position and level. Training programs and courses are continually updated and provided at field sites or at either of the two postal training centers, W. F. Bolger Center for Leadership Development, Potomac, MD, and the National Center for Employee Development in Norman, OK. The Postal Service develops and delivers a continuum of training and developmental programs for supervisory personnel, managers and executives. It consists of a battery of educational experiences beginning with the Associate Supervisor Program for individuals just beginning a career in management. It continues with the Career Management Program that provides supervisors and managers the leadership skills necessary to manage people. The Advanced Leadership Program develops higher level EAS managers for an executive talent pool. Core technical programs are in place to cover building systems, vehicle maintenance and supervision, automation equipment, material handling, vending equipment, maintenance management, and environmental and safety issues. When the Postal Service purchases new mail processing equipment, vending and revenue protection software, and new vehicles or enhances current machines or processes, specific training courses are developed and delivered to the appropriate maintenance personnel, operators and supervisors. This year the Processing and Distribution Management Program was rolled out to build technical competence for employees on succession plans for the position of Plant Manager.

12. How does the Service communicate with its unions and employee associations on these issues so that Postal Service employees share an understanding of the organization's financial situation?

The Postal Reorganization Act (PRA) gave postal employees the right to bargain collectively over wages, hours, and working conditions. Substantive information concerning the financial condition of the Postal Service is therefore central to the collective bargaining process. The unions receive detailed information concerning the current and projected financial health of the Postal Service during collective bargaining. In addition to information received during collective bargaining, the unions receive various reports on an on-going basis. Such reports include the National Payroll Hours Summary Report that details salaries and benefits for postal employees, the On-Rolls and Paid Employee Statistics Report that details complement information by union, and the Financial and Operating Statistics Report that details financial and operating statistics.

The PRA also established a program of consultation with our three management organizations, comprised of supervisors and other managerial personnel and postmasters who are not subject to the collective bargaining process. The management associations meet with representatives of the Postal Service each month to discuss issues which involve the planning and development of pay policies and schedules, fringe benefit programs, and other programs relating to supervisory and other managerial employees. Information provided on the financial condition of the Postal Service is integral to these discussions.

More general information concerning service and financial issues reaches both craft and management employees directly through a variety of headquarters, area, and district in-house publications.

13. The Postal Service states that 80 percent of its costs are employee costs that are influenced by the decisions of arbitrators. What percentage of the employee cost is attributed to bargaining unit employees and what percentage to non-bargaining unit employees?

Bargaining unit Salary and Benefits comprise 90.7% of total Postal Service Salary and Benefits, and non-Bargaining Unit employees comprise 9.3% total Postal Service Salary and Benefits.

14. What has been the annual salary increases of bargaining unit employees over the past six years?

Annual salary increases vary by bargaining unit. The following tables provide the annual salary increases for the American Postal Workers Union (APWU), the National Association of Letter Carriers (NALC), the National Postal Mail Handlers Union (NPMHU), and the National Rural Letter Carriers' Association (NRLCA). For ease of comparison, increases are based on the top step of the predominant grade in each salary schedule. I would note that the cost of benefits for bargaining unit employees is roughly an additional 40 percent of salary.

1)APWU Grade 5 Step O

Year	Salary @ 1/1	COLA Payments	General Increase	Total Increase	Percent Increase	Salary @ 12/31
1995	$35,604	$0	$427	$427	1.2%	$36,031
1996	$36,031	$520	$0	$520	1.4%	$36,551
1997	$36,551	$478	$427	$905	2.5%	$37,456
1998	$37,456	$375	$757	$1,132	3.0%	$38,588
1999	$38,588	$395	$532	$927	2.4%	$39,515
2000	$39,515	$957	$0	$957	2.4%	$40,472

2)NALC Grade 1 Step O

Year	Salary @ 1/1	COLA Payments	General Increase	Total Increase	Percent Increase	Salary @ 12/31
1995	$35,604	$0	$427	$427	1.2%	$36,031
1996	$36,031	$520	$0	$520	1.4%	$36,551
1997	$36,551	$478	$427	$905	2.5%	$37,456
1998	$37,456	$375	$0	$375	1.0%	$37,831
1999	$37,831	$395	$1,287	$1,682	4.4%	$39,513
2000	$39,513	$957	$1,479	$2,436	6.2%	$41,949

3)NPMHU Grade 4 Step O

Year	Salary @ 1/1	COLA Payments	General Increase	Total Increase	Percent Increase	Salary @ 12/31
1995	$33,869	$0	$417	$417	1.2%	$34,286
1996	$34,286	$520	$0	$520	1.5%	$34,806
1997	$34,806	$478	$417	$895	2.6%	$35,701
1998	$35,701	$375	$739	$1,114	3.1%	$36,815
1999	$36,815	$395	$517	$912	2.5%	$37,727
2000	$37,727	$957	$0	$957	2.5%	$38,684

4)NRLCA 40 Hours Step 12

Year	Salary @ 1/1	COLA Payments	General Increase	Total Increase	Percent Increase	Salary @ 12/31
1995	$33,815	$0	$427	$427	1.3%	$34,242

1996	$34,242	$520	$0	$520	1.5%	$34,762
1997	$34,762	$478	$427	$905	2.6%	$35,667
1998	$35,667	$375	$0	$375	1.1%	$36,042
1999	$36,042	$520	$1,287	$1,807	5.0%	$37,849
2000	$37,849	$957	$0	$957	2.5%	$38,806

Salary increases shown above are based on scheduled increases resulting from either negotiations or interest arbitration. Changes in salaries due to factors such as automatic step increases, promotions, changes in the rate of hiring/attrition, etc. are not included in the above analysis. There are nearly 700,000 career employees represented by the APWU, the NALC, the NPMHU, and the NRLCA. In addition to these major categories, the Postal Service also negotiates agreements with unions representing postal nurses, postal police, information technology, and tool and die unit employees. These smaller classifications account for about 2,500 employees. Annual increases for these groups are typically in the 2.5-4.0% range.

RESPONSES FROM GEORGE OMAS TO ADDITIONAL QUESTIONS FOR THE RECORD

Questions from Senator Thompson:

A. Some believe the current statute provides pricing flexibilities which have not been utilized by the Service, such as phased-in rates. Do you believe the current statute provides for such flexibility? If so, what additional rate setting flexibilities could the Service use in order to allow for some predictability in postal rates?

Yes. Section 3622(a) of Title 39 explicitly states: "The Postal Service may submit such suggestions for rate adjustments as it deems suitable." This authority apparently would include phased-in rates, as well as other options for managing the number and timing of rate changes.

In 1992, a joint Postal Service—Postal Rate Commission task force recommended the establishment of a four-year ratemaking cycle, featuring major rate changes every four years, together with interim minor rate adjustments every two years. However, when the Commission thereafter initiated a rulemaking to implement such a program, the Postal Service withdrew its support for the concept. Either phased-in rates recommended in a single rate proceeding, or establishment of an agreed-upon ratemaking cycle of known duration, could allow for more predictability in the timing of rate changes.

The current statute provides the Postal Service with broad pricing flexibility to employ pricing techniques such as phasing, open service agreements, seasonal, or peak/off-peak rates, subject only to two constraints. First, it must make its intentions public by filing a request with the Postal Rate Commission. Second, its pricing must not contravene the policies of the Act, e.g., rates shall be fair and equitable (39 U.S.C. §101, §3622(b)(1)), rates shall not be unduly discriminatory (39 U.S.C. §403(c)) and rates shall be cost based (39 U.S.C. §3622(3)).

Because the Postal Service is a government owned and sponsored monopoly provider of a nationwide public service, I do not believe it should be allowed to change its rates without notice and providing the opportunity for meaningful public review. Americans depend on the mail for essential communications, financial transactions, educational material, and voting. Rate changes can alter many social and economic patterns. Because the Postal Service also offers products in direct competition with private enterprises, it could – without proper oversight – recoup losses from below cost rates on these products by unfairly raising rates from its captive monopoly users.

Under current legislation, the Postal Service is not subject to the antitrust laws. Therefore, competitive private enterprises have no corrective remedies or legal recourse. Current oversight of the Postal Service, while very limited, at least provides rate transparency in advance of rate changes, enabling citizens and businesses to prepare responsive actions.

B. The Postmaster General has called for legislative reform that includes pricing flexibility. In your opinion, what sort of pricing flexibility should the Service be granted? Why?

My answer to question A. describes the broad pricing flexibility already enjoyed by the Postal Service. I am not aware of any pricing technique that the Postal Service would utilize but for some current restrictive provision of the Act. The Postal Service has often expressed a desire to enter into confidential service agreements with large mail users. Such an option could make it difficult for smaller users, individuals, and competitors to protect their own interests.

There is one area where the Postal Service may have too much flexibility now. When the Governors unanimously believe that the evidentiary record-based rates recommended by the Commission will not provide sufficient total revenues, including a reasonable provision for contingencies, the Postal Service can modify those recommended rates. The availability of this option may explain the Postal Service's decision to withhold evidence on recent financial results at the conclusion of the most recent rate case.

C. What authority does the Rate Commission have to alter the USPS revenue request? Is there precedent for this?

The Postal Reorganization Act provides that "rates and fees shall provide sufficient revenues so that the total estimated income and appropriations to the Postal Service will equal as nearly as practicable total estimated costs of the Postal Service." 39 U.S.C. § 3621 (emphasis added). This is widely referred to as the "break-even policy" of the Act. The task of recommending rates in accordance with that policy, among others, is the responsibility of the Postal Rate Commission. 39 U.S.C. § 3622(b).

The Commission must develop the best possible estimates of what Postal Service costs and revenues will be in order to design rates that meet the break-even policy. This frequently has required the Commission to correct projections that formed the basis of Postal Service revenue requests. Adjustments have been made that both increased and decreased the Service's revenue requirement.

One type of change can occur when amounts initially estimated in the Postal Service's request for future periods—such as cost-of-living wage increases and the costs of worker's compensation claims—become fixed and known during the course of a rate proceeding. These amounts frequently differ from the Service's initial estimates, and when they do, the Commission makes corresponding adjustments in cost or revenue estimates. The Commission has made changes of this type to reflect "known and certain" amounts in most omnibus rate cases, and the Postal Service apparently does not dispute the PRC's authority to do so.

Another source of change in the level of revenue requirement are revisions in cost or revenue estimates resulting from evidence presented during the course of the proceeding, either by the Postal Service itself or another participant. For example, in the R2000-1 proceeding, the Postal Service filed supplemental

evidence at the Commission's request that supported a net increase in the revenue requirement. However, in the same proceeding, mailers of periodicals sponsored evidence that led to a net reduction of revenue needs on the basis of new cost avoidance programs.

However, the PRC's authority to alter the revenue request is limited in that it makes recommendations that are either accepted by the Board of Governors, or, if the Board votes unanimously, can be overridden. Further, because the PRC has no subpoena authority, its ability to adequately assess the Postal Service's revenue request is limited to a review of the costs that the Postal Service chooses to disclose and enumerate.

Questions from Senator Akaka:

1. Are there different types of rate filing available to the Postal Service that the Service is not using now?

   Yes. The Postal Service has broad statutory authority to seek any type of rate change it considers to be in the public interest. This would extend to requests for targeted changes applicable to a limited number of rates or fees. However, the Service has demonstrated a preference to adjust rates relatively infrequently, and simultaneously for all classes of mail and types of service. Therefore it has filed only "omnibus" rate requests in recent years.

2. Some have said that relations between the Board of Governors and the Postal Rate Commission could be improved. What steps would you recommend to enhance communication between the Board of Governors and the PRC?

   I believe that more frequent communication between the Board of Governors and the Postal Rate Commission would be very beneficial. Increased communication should foster a better joint understanding of the separate but complimentary functions and obligations of our two bodies. For that reason, shortly after the conclusion of the recent omnibus rate case I wrote to the Chairman of the Board of Governors suggesting that we arrange an opportunity for the Board and the Commissioners to exchange views. I am pleased to say that an informal get together has been planned for September, when the Governors next meet in Washington D.C.

3. Raising postal rates generates much debate. Whenever a rate case is filed, there are those who claim the Postal Service doesn't need the additional revenue and that raising rates forces some customers to find alternatives to the mails. In the 1997 rate case, some said that because the Postal Service had a surplus, it didn't need to raise rates. However, if the Service files for a rate increase only when it appears that revenue is going down, doesn't that put the Postal Service at a disadvantage by causing further deterioration of its financial situation?

You make a very important point – there is no "good" time to raise rates. The demand for many postal products is relatively inelastic, so that when postal rates and fees are increased the Service reaps additional income notwithstanding the fact that it loses some business. Nonetheless, when businesses like the Postal Service raise their prices, customers on the margin will be able to purchase less service.

Whether the Postal Service is generating a surplus or experiencing losses, customers forced to pay higher postal rates suffer, because they must spend more to obtain the same amount of service. Some customers may not be able to shoulder this additional burden. The best way to avoid this problem is for the Postal Service to focus on restraining costs. The Postal Service will not need to increase its rates if it can keep its cost increases smaller than its productivity improvements.

POSTAL RATE COMMISSION
Washington, DC 20268-0001

George A. Omas
Commissioner

September 10, 2001

The Honorable Fred Thompson
Committee on Governmental Affairs
U.S. Senate
Washington, DC 20510

Dear Senator Thompson:

On June 22, 2001 I provided responses to a number of questions arising from my May 15, 2001 testimony before the Senate Committee on Governmental Affairs. In response to a question (#2) from Senator Akaka concerning communications between the Board of Governors of the Postal Service and the Postal Rate Commission I stated that I had contacted the Chairman of the Board of Governors and arranged for a meeting to be held in early September.

I must now report that this meeting has been cancelled by the Board of Governors.. The Chairman of the Board of Governors has written me stating that he believes meeting with the Commission while the Board will be considering whether and when to file another rate request could give rise to misleading speculation. No alternative meeting date was suggested.

I think it is appropriate that strict *ex parte* rules apply concerning matters pending before the Commission. Historically, when an omnibus rate case is pending before it, the Commission has avoided informal contact with the Board of Governors. Nonetheless, I continue to believe that more frequent communication between the Board and the Commission would be beneficial, and I am disappointed that our scheduled meeting will not take place.

Sincerely,

George Omas

George Omas
Vice Chairman

cc: The Honorable Joseph I. Lieberman
The Honorable Daniel Akaka
The Honorable Thad Cochran

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