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THE STATE OF THE U.S. POSTAL SERVICE ONE YEAR AFTER REFORM

HEARING

BEFORE THE

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

OF THE

COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS UNITED STATES SENATE

ONE HUNDRED TENTH CONGRESS

SECOND SESSION

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THE STATE OF THE U.S. POSTAL SERVICE ONE YEAR AFTER REFORM

WEDNESDAY, MARCH 5, 2008

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

The Subcommittee met, pursuant to notice, at 2:38 p.m., in Room SD–342, Dirksen Senate Office Building, Hon. Thomas R. Carper, Chairman of the Subcommittee, presiding.

Present: Senators Carper and Akaka.

OPENING STATEMENT OF SENATOR CARPER

Senator CARPER. The Subcommittee will come to order please. I want to welcome our guests. It is nice to see both of you. We thank you for making time on your schedules to be here with us today for this oversight hearing.

I am delighted to be here with my friend, Senator Akaka, and I am going to make an opening statement and yield to him for one, and then I do not think Senator Coburn is going to be able to join us. Others of our group may wander in and out and we welcome them if they do. But we are delighted that you are here. We look forward to an informative hearing.

My thanks, as well, for all the work that both of you and the folks that you represent, that you lead are doing, in moving swiftly to implement the postal reform which we worked on and negotiated. I see some people in the audience who worked here with us to try to make it the law of the land.

Now, we always said if we ever get it enacted, we are going to make sure that we have appropriate oversight hearings to see how we are doing, what is working well and what is not. So this is part of the process.

This is, I think, an interesting time in a lot of ways for us in this country but an interesting time for those of us who have had and continue to have an interest in postal issues. The Postal Accountability and Enhancement Act (PAEA) has been the law of the land for more than a year now and we are starting to see some results and some benefits, I think, as well.

The Postal Service is set to change prices this spring using the streamlined cap based rate system called for in the Act. It is my hope that the Postal Service can use this new rate system in the

coming years to offer customers some level of predictability and to be more competitive in the advertising and the mailing markets in which they compete.

We also have a new set of service standards, as we know, for most postal products that I hope will make the Postal Service more relevant and more valuable to their customers now than has maybe been the case in other days. Customers have a lot of communications options. We want to make sure that this is a valued one for them.

These developments, coupled with what appears to be an even stronger effort underway under the rate cap system to control costs, should have us celebrating, I think. But these are difficult times for the Postal Service as they are for many in our country, not only families but businesses too.

During the last fiscal year, the Postal Service reported losses of about $5 billion and, as we know, this was largely due to a one-time accounting charge related to several provisions in the Postal Reform Bill related to the disposition of the Postal Service's pension payments, as I recall.

However, this year, if everything remains unchanged, and we know they are not going to remain unchanged, but if they were to remain unchanged and we were going on autopilot, something that the Postal Service is not doing, the Postal Service could suffer losses, approaching $2 billion.

I know that planned cost cutting and also the revenue that would be earned from the May price increase will bring in, will bring that number down. But the projected losses can tell us a lot about the current state of our economy. They can also, unfortunately, probably tell us a lot about the Postal Service's customer base.

The slow down in the housing and the credit markets has hurt some pretty big Postal Service customers and that has hurt them badly. I hope that some of that lost business will start coming back in the months ahead but we can never know if some of the mail volume that has been lost due to the economic downturn might never come back. We hope that it will but we do not know.

As General Potter will point out, a lot of businesses that have counted on the Postal Service to communicate with customers are now encouraging their customers to move online, in some cases incentivizing them to move online.

It seems that postal customers who would rather not pay postage now have more options available to them, maybe even more than they had during the last major economic downturn that occurred when I first arrived in the Senate just a little more than 7 years ago.

So it is important that the Postal Service make full use of the tools available to it through postal reform. I have been pleased with what I have seen so far but there is plenty of work ahead for all of us.

We look forward to hearing from our witnesses today about some of the challenges and some of the opportunities that are out there. We also would like to hear how Congress can work with the Postal Service and with the Postal Regulatory Commission to weather the current storm and maybe find a few new ways for revenue and cost-cutting opportunities.

Senator Akaka, welcome. We are glad you are here.

OPENING STATEMENT OF SENATOR AKAKA

Senator AKAKA. Thank you very much, Mr. Chairman. I want to thank you for holding this hearing, and I want to also extend my warmest aloha and welcome to Postmaster General Potter and also Mr. Blair.

Right now is an exciting time in the postal community. Over the past year both the Postal Service and Postal Regulatory Commission (PRC) have been working tirelessly to implement provisions that we passed in the Postal Accountability and Enhancement Act now a little over a year ago.

Perhaps the most apparent change has been the first rate filing under the new inflation cap. This process, I am sure Mr. Blair and General Potter will agree, has greatly streamlined the rate increase process ensuring predictable increases that we hope will not cause undue rate shock.

I want to commend Mr. Blair and the PRC for issuing the new rate regulations in such a timely fashion, ensuring the Postal Service could quickly take advantage of the new flexibilities. Importantly this new system provides more flexibility for the Postal Service and a check by the PRC on new rate increases, the first of which was recently submitted.

Now more than ever there is the need to look to the future and watch the economic winds to ensure that increases under the cap are fair and that there is enough unused rate authority banked up for future needs should they arise.

The Postal Service's latest financial information showed that even by using virtually all of its rate authority, it barely broke even. This further emphasizes the need to allow room for unanticipated future needs. As the economy slows and the mail use declines, the Postal Service needs to look at both revenues as well as expenses to balance the bottom line.

I know that the Postal Service is already taking a hard look at expenses and implemented important reforms to save money. I applaud these efforts and encourage you to keep finding new opportunities for savings.

That being said, I also want to emphasize the importance of continuing to foster a dedicated Federal workforce at the Postal Service to ensure the highest quality of workers and confidence for the public.

Recently the Postal Service created a set of modern service standards which I hope will more accurately reflect the flow of the mail giving more transparency for postal customers.

Now that the Postal Service has developed these standards, they should serve as a baseline for a constantly evolving effort to find opportunities for increased efficiencies. In many ways, the fruits of our labors in creating this postal reform are just beginning to show. There is still much work ahead but I am confident that under the leadership of General Potter and Mr. Blair we will continue to foster a stronger, more transparent Postal Service with a dedication of universal service to the American people.

Thank you very much, Mr. Chairman.

Senator CARPER. You bet, Senator Akaka. Again thank you so much for being part of this today.

Our witnesses are ones that are very familiar to this Subcommittee. I am not going to take a lot of time to introduce them but I would like to say a few things.

Jack Potter is the Postmaster General, the chief executive officer of the U.S. Postal Service. He has served in his current positions since June 2001, arriving just after I got here so our terms have sort of coincided. He did not have to run for election but I think if he had he would have won. Before 2001, General Potter has served in a number of top leadership positions at the Postal Service. He first started with the Postal Service as a clerk, is that right?

Mr. POTTER. That is right.

Senator CARPER. In your native New York. Where in New York?

Mr. POTTER. The Bronx.

Senator CARPER. In the Bronx. In 1978 at the age of 12. [Laughter.]

Is that a typo? Well, he was at least 12, maybe a bit older.

Dan Blair is the first chairman of the Postal Regulatory Commission. And our State, Delaware was the first State to ratify the Constitution and for one whole week Delaware was the whole United States of America, and our State motto is "It is good to be first" so you, my friend, are in that tradition.

But the first chairman of the Postal Regulatory Commission. He was named chairman in December 2006 just after being confirmed as a member of the old Postal Rate Commission. Prior to joining the Commission, Mr. Blair served as Deputy Director of the Office of Personnel Management. Before joining the Executive Branch in 2001, Mr. Blair worked for 17 years on Capitol Hill including some time for this Committee's former chairman, Senator Fred Thompson from Tennessee, and Mr. Blair just returns from leave where, on the campaign trail, he was the campaign manager for the presidential campaign of Fred Thompson, and let me welcome you back to your day job. [Laughter.]

We welcome you both. Your full written statements will be made part of the record. Both of you have roughly 5 minutes but we are not going to run the clock on this. So if you need a little more time, just go ahead and take it, and we hope to have the opportunity to ask you some questions.

Again, General, I like to call him General. General Potter, take it away and then we will kick it over to Mr. Blair.

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

Mr. POTTER. Good afternoon, Chairman Carper, and my good friend, Senator Akaka.

I am pleased to report today on the Postal Service's first year of operation under the Postal Act of 2006.

The new law created needed pricing flexibilities that will benefit the Nation by keeping mail a welcome, efficient, and cost-effective

[1] The prepared statement of Mr. Potter appears in the Appendix on page 27.

way to link every household and every business in America. But with a growing network that reaches 148 million homes and businesses every day, we are extremely sensitive to fluctuations in the economy and to changes in consumer preferences for hard copy or electronic communication. The new law, for all its benefits, does not exempt the Postal Service from these facts. Compounding the diversion of some mail to the internet, we have been hard hit by today's underperforming economy. The financial, credit, and housing sectors are key drivers of our business. The recessionary trend in these industries is reflected in declines in mail volume and revenue.

By the end of the first quarter, mail volume was down 3 percent from a year earlier. First-Class Mail fell by almost one billion pieces and Standard Mail by some 750 million pieces. Less volume means higher overhead costs per piece of mail handled.

Revenue was $525 million below plan in the first quarter and net income fell short by $183 million. We see no improvement this quarter. Facing this extremely difficult situation, the men and women of the U.S. Postal Service stepped up. They brought down spending, narrowing the revenue gap created by the sudden steep volume decline.

Faced with a possible $2 billion budget shortfall this year, we are looking to grow revenue through aggressive pricing and sales and cutting additional costs on top of what we had already planned to reduce our cost by but not at the cost of service.

Despite quarter one's financial challenges, our people delivered the strongest service in our history. On-time overnight delivery of First-Class Mail reached 96 percent: The first time we have ever done that in quarter one of a fiscal year. Two-day mail rose to a record 93 percent on-time, and 3-day mail matched our all-time high. So when you think about it, we have a lot going for us.

For the third year in a row, we have been rated the most trusted government agency. Customer satisfaction is at an extremely strong 92 percent. Our brand is strong and our business is well positioned to rebound with the economy. But we cannot simply wait for the recovery or to cost-cut our way out in this situation we are in thinking that prosperity is just going to happen. We must also pursue an aggressive revenue growth strategy.

On May 12, we are adjusting prices for our market dominant products, First-Class Mail, Standard Mail, periodicals and package services, using the law's new simplified pricing regulations which call for annual price changes. This can produce some $735 million in additional revenue this year alone. To close the remaining budget gap, (and we think that there is going to be, obviously, some cost-cutting) we need to focus on growing beyond, above and beyond what the rate change would bring us.

So we are pursuing growth through an innovative price structure for our competitive products or shipping services. We will make these products—our package products—more attractive through incentives and enhanced features. The new prices will be announced shortly for a May 12 implementation.

Senators our people are ready. They understand the challenge and they are ready to use every new tool that the new law provides in order to be successful.

I am particularly gratified by the support of our unions. With their help, our employees are out talking up and selling our products. They are making sure customers understand the value of the mail and how it can work to help them in their personal lives and help their businesses.

When we look at the new law, a lot has happened over the past year, and it is not just the Postal Service alone that has been active. Other agencies and the entire mailing community have made major contributions to the progress that has been made to implement the new law.

There have been many subjects covered and my long testimony details some of them. But I would like to just list some of the things that have happened.

We have changed the worker's compensation procedures called for in the new law. We put in new purchasing regulations. Data handling policies have been changed for legal activities. Our employee safety program has stepped up and we have issued the reports required. We are planning for international customs, the ones that were requested. We put that work behind us. We have done and made the changes necessary. We have put together a new classification schedule for mail. We have had assessments and appeals for non-profit mailings over the course of this year. Diversity management and purchasing contract reports have been given to the Congress.

We have looked at, and with the Treasury, accounting for market dominant and competitive products and a report was issued to the Postal Regulatory Commission. The Postal Service and the mailing industry have stepped up on recycling, and we have issued a report on that.

We have submitted our first annual compliance report and we are looking forward to the PRC's response on that. We are working with them to make sure it is even better the next time around.

We are working feverishly to come into compliance with Sarbanes-Oxley. The Federal Trade Commission's findings are out and they show that the Postal Service is at a competitive disadvantage because of the burdens of being part of the government.

The development of modern service standards as you referred to, Senator Carper, have been done and we really are happy that we got so much input from the mailing community as well as the PRC. And we are in the process now of working through and will meet the schedule to put new service measurement systems in place, again working with the PRC and, as we referred to earlier in my testimony, we are implementing the new pricing regulations.

I want to thank Chairman Dan Blair and the entire Postal Regulatory Commission for their efforts to move as quickly as they did to issue the new pricing regulations. The fact that they were so far ahead of schedule really was very instrumental in terms of us being able to put together a plan for this fiscal year so that we can strive to break even this year. All these important tasks require community cooperation and I am grateful for everyone's assistance.

We are also changing how we speak about our business, to make it clearer for customers. We are not talking about rates anymore. We are talking about prices. It is not negotiated service agreements

because when you go to a customer, they do not know what that is. But they do understand contract pricing.

Market dominant products—that does not mean anything in the real world so we are calling that mail, mailing services. And competitive products, people do not know what a competitive product is but they know that shipping services are packages, and so when we talk in the marketplace, that is the language we use.

We are entering a period of profound change, and through the new postal law, you have provided us with a new ability to navigate the change. I am grateful for your continuing support of a sound and financially independent Postal Service that can serve our Nation long into the future.

Thank you for giving me the opportunity to make some remarks and I will be happy to answer any questions that you might have.

Senator CARPER. Fair enough. Thanks so much, General Potter.

Mr. Blair, you are recognized, again for 5 minutes or so. If you take a little bit longer, that is OK. I do not know if there is anyone here you want to introduce but if there is, feel free.

STATEMENT OF THE HON. DAN G. BLAIR,[1] CHAIRMAN, POSTAL REGULATORY COMMISSION

Mr. BLAIR. Thank you, Chairman Carper. I appreciate that. Senator Akaka, thank you for your kind words. They are most appreciated.

Thank you for this opportunity to appear today with an update on the activities of the Postal Regulatory Commission. I am pleased to be here with Postmaster General Potter and greatly appreciate his kind words for the work of the Commission this past year.

My written testimony gives a complete agenda of our activities, and I am pleased to summarize my statement. I ask that my written testimony be submitted for the record as well.

Senator CARPER. It will be unless Senator Akaka objects. Do you?

Senator AKAKA. No.

Senator CARPER. No objection for a change. All right. That is good.

Mr. BLAIR. Thank you, sir. This has been a very busy year for us at the Commission. Standing up the regulatory framework 8 months ahead of schedule, consulting with the Postal Service on the development of modern service standards, completing one last final rate case under the old regulatory regime topped the list of those activities.

It was a fulfilling year, but we cannot rest on our accomplishments since this upcoming year presents us with equal, if not greater, challenges. Our agenda this year includes further consultation on service standard goals and performance measurement systems.

Last week, I had the chance before the House Subcommittee, to compliment the Postmaster General and his team at the USPS, headed up by Deputy Postmaster General Pat Donahoe, for their work with us on the development of the service standards and our continuing consultation. I would like to do that again.

[1] The prepared statement of Mr. Blair appears in the Appendix on page 40.

The PRC's efforts in this area added value, and I am pleased that many of our suggestions over the past few months were incorporated in the final service standards.

Our monthly meetings have proved to be an excellent conduit for consultations and communication in other issue areas as well. This open and ongoing dialogue helps make our system work better, and I look forward to continuing the practice.

Currently we are undertaking two new PAEA reviews. First we are reviewing the data provided by the Postal Service as part of its annual compliance report, and we are reviewing the rate adjustment filing under the new regulatory framework submitted by the Postal Service on February 11.

While we are in the mid-stages of an evolving process, I am hopeful that this less litigious environment, brought about by the PAEA, continues to produce a better exchange of information between the Commission and the Service. With the experience we have gained in the review of the first annual data submission by the Service, the Commission will shortly propose rules to tighten up the process. The first annual report has identified areas for data collection, special studies and cost models that need updating.

We are also working on the Universal Service Obligations Study which was mandated by the Postal Accountability and Enhancement Act. We plan to solicit views from the Postal Service, other Federal agencies, the postal community, and the general public on their expectations of universal postal service.

Given the scope of the study, we are supporting our Commission work through a competitively awarded contract with George Mason University's School of Public Policy. We expect to engage in broad public outreach as well as conduct several field hearings to gauge the mailing public's needs and perceptions. We plan a very comprehensive and well documented report.

As I mentioned in my written statement, we believe our congressionally mandated report will have the benefit of the findings and recommendations of the separate report being prepared by the Postal Service through the National Academies of Science, and I want to thank Postmaster General Potter for his assistance in this area.

I am also pleased to report that the Commission has formally released its first strategic and operational plan, detailing the agency's vision and goals over the next 5 years. The plan outlines the strategies and activities that the Commission will use to help ensure transparency and accountability of the Postal Service and to foster a vital and efficient universal mail system. By emphasizing the operational work that must be accomplished over the next 5 years, the Commission can evaluate its progress and performance on the strategic goals outlined in the plan.

To conclude, Mr. Chairman, those are several of our front-burner issues. An additional priority is to see the successful confirmation of a new commissioner to fill our one vacancy. We have pending the notices of rate adjustment under the new rules as well as Commission action on the Postal Service's compliance data. Therefore, a full complement of commissioners to take action on these two new important aspects of Commission authority would be very beneficial.

I am pleased to report that last week President Bush nominated Nanci Langley, sitting in back of me, to fill this seat. Many of you may know Ms. Langley from her long-time work for Senator Akaka on this Subcommittee. She is currently the Commission's Director of Public Affairs and Government Relations. I hope the Committee can take swift action in forwarding her nomination to the full Senate.

My written testimony goes into further detail, and I am pleased to answer any of your questions. Thank you.

Senator CARPER. Thank you very much, Mr. Chairman. When Nanci Langley worked for Senator Akaka, I oftentimes would observe her lips moving when he spoke, and I just noticed that she has your back. I could just barely see her lips move when you spoke, too. That is a trait that served her well when she was here in the Senate and now for the Commission.

And if you watch carefully, you will probably see John Kilvington, his lips move when I speak too. [Laughter.]

I want to go back, at least to start off, to our Postmaster General. You mentioned some measures of performance and they were not financial in nature but they dealt with, I think, 1-day mail, 2-day mail. Just go over those again. I thought those were impressive.

Mr. POTTER. Those numbers were from our first quarter which runs from October 1 to December 31. Generally it is a somewhat difficult delivery time for us because we have holiday volumes as well as we start to get the effects of winter weather, and so we are very proud of the fact that, in the first quarter, our First-Class overnight service performance reached an all-time high of 96 percent for that quarter. It is the first time we have ever done it.

Our 2-day service was at 93 percent, and that again is a record performance at any time, and 3-day we matched our all-time high of 88 percent in that quarter.

So, we look at the opportunity to or the challenge of, cutting costs and we do not do that independent of service. We do not and try not to, as best we can, risk service. So our efforts, I think, prove well.

We saved over $350 million off of our plan in the first quarter, but we did it with an eye toward getting the mail out and being more efficient at moving the mail and moving it correctly the first time.

So as your quality improves, your handlings go down and your service goes up so we are very proud of the results and Pat Donahoe and his entire crew, the Deputy Postmaster General COO, and all the people in the field, deserve a lot of credit for what they were able to do.

Senator CARPER. My congratulations to all of you.

You mentioned the legislation called for some changes in worker's comp. Would you just talk about how that is being implemented? How that is going?

Mr. POTTER. Well, it is a matter of a small change in terms of a waiting period for worker's comp when somebody was injured and so it was a matter of just a quick change in our procedures and that has been accomplished. Now there is a 3-day waiting period before you can begin receiving worker's comp and we implemented

that within a couple of months of the new law being signed into law by the President.

Senator CARPER. How is that being received? How is it working?

Mr. POTTER. For the most part I have not heard anything about it. I know when it was put in place, there were people who were concerned about it. But it really has not surfaced as an issue since it has been implemented.

Senator CARPER. In your testimony you mentioned the word "recycling." And my ears picked it up immediately. Senator Olympia Snowe and I are the co-chairs of the recycling caucus in the U.S. Senate. Most of you probably did not know there is a recycling caucus but there is, and Olympia and I are the co-chairs.

But you said that the Postal Service is doing a better job on recycling. Just give us a little bit more information on that.

Mr. POTTER. Well, from a number of fronts. First of all, we obviously have waste inside the Postal Service and we have made it a goal of ours to increase the amount of mail and paper that we recycle and other wastes that the Postal Service recycles.

Senator CARPER. So you admit that you are recycling mail, is that it?

Mr. POTTER. Mail that is undeliverable as addressed we recycle.

Senator CARPER. That will be the lead in all the news stories. Postmaster General admits to recycling mail.

Mr. POTTER. Well, we do. If it is undeliverable as addressed, we would rather put it into a recycling program than to put it into a landfill.

Senator CARPER. I understand.

Mr. POTTER. We also have people who come into our lobbies, P.O. boxes, and receive mail, and we provided them an opportunity to read it and recycle it right there as opposed to putting it into waste baskets for them and they use them for whatever and we recycle the paper that is put into those recycling bins now.

We also recycle a lot of industrial materials that we use, batteries, oils, and other things that we try to find the best home for.

Another area that we are very proud of is our new boxes for Priority and Express Mail. We reduced the numbers and types of boxes we had and we work with an organization called Cradle to Cradle and got their certification to make those boxes environmentally friendly and to make sure that they did not do damage to the environment should they wind up in a landfill.

We would prefer that people recycle them but it was a great exercise because we learned. That when you deal with something as simple as a cardboard box with a little printing on it, it was amazing to see how many suppliers we had to go to in order to get that box to be as environmentally friendly as we could. It was not just the provider of ink. It was the supplier to our ink supplier. It was the paper suppliers. The chemicals that are used in paper, and so we have come a long way. We are learning quite a bit. We are doing our part to try and keep the environment friendly and reduce any harm that we might bring to the environment.

Senator CARPER. Good. Let me stay on that theme for just a moment. I will ask one more question and then hand it over to Senator Akaka.

With respect to the issue of the greening of the Postal Service, would you talk to us a little bit about what you see ahead in terms of the vehicles, the kinds of vehicles that you acquire, purchase, lease, and how you might do something that is positive with respect to our environment?

Mr. POTTER. Well, today we have the largest alternate fuel vehicle fleet of any organization in America. But we have been somewhat constrained by the law in terms of what types of vehicles we could purchase that would satisfy the environmental requirements for Federal agencies.

Since the last time we had a hearing, and I am grateful to the Senate, a law has been passed that has increased the flexibility that the Postal Service has in terms of future buys of engines for our vehicles, whether it is replacement engines or for new vehicles that will meet the Federal requirements.

So we are anxious to begin to study the use of hybrids vehicles for our trucks and our lighter weight vehicles and we are in the process of looking at all sorts of different energy sources.

In fact, we hosted at one of our vehicle maintenance facilities right here in the Washington DC area, the President, Secretary of Energy, and we had our trucks along side of FedEx, UPS, and DHL vehicles because everyone in the delivery business is looking to the future and looking to try and make the changes that will help the environment going forward.

So I appreciate the new law that was passed and the flexibility that the Postal Service has been given when it comes to future vehicle purchases.

Senator CARPER. I am glad you are taking advantage of that flexibility and look forward to hearing more of what is to come.

Senator Akaka.

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

General Potter, I want to commend you and the Postal Service for the gains you have made in the past year. It has been done with the help of everybody in the Postal Service and I am glad to hear your testimony this morning about how you have come along.

As you know, the Postal Service must begin Sarbanes-Oxley style financial reporting by fiscal year 2010 which is about in 2 years. I have been a strong advocate of increased transparency in financial accounting, and I sort of felt tickled when you mentioned the words "competitive product" as making it more transparent to the public so that they understand what you are trying to do there.

How far along is the Postal Service in implementing both the policy and technical changes in order to prepare for the Sarbanes-Oxley reporting?

Mr. POTTER. Well, the most obvious thing to people who look at our financial results is the fact that we are now in compliance with SEC-like reporting on a quarterly basis. In addition to that, we have made extensive efforts internally to make sure that we are putting in place the types of controls that are necessary to meet the requirements of the Sarbanes-Oxley Act. We are working closely with our auditor, Ernst and Young, and we brought Deloitte and Touche in as our consultant that is looking at, again, both of those well known audit or accounting firms are helping us with the implementation.

So, Senator, I would say we are well along. It is, as you are probably aware, a very exhaustive effort. The Board of Governors of the Postal Service have really stepped up and have taken the lead to make sure that we are in compliance and they are very aware of their role, and it is a much more difficult task for a board under Sarbanes-Oxley than they had previously done.

So I am really grateful for the work that they have done and so everybody is involved and are working hard to make sure that we put into place the type of controls that will create the kind of surety that I need to have in order to sign those documents every quarter, that they are sound and that our reports are accurate and the goal of transparency is one that we embrace.

Senator AKAKA. Mr. Blair, as you stated in your testimony, the Postal Reform Bill requires that by December of this year, the PRC issue a report on the current state of the Postal Service's universal service obligation and recommend necessary reforms.

This issue is especially important to rural and isolated areas such as Hawaii who depend on universal service.

Has the PRC made progress on this report and what outside stakeholders do you plan to work with in conducting your assessment and developing recommendations?

Mr. BLAIR. Thank you, Senator Akaka, for the question. I am happy to answer that.

We have made progress on this. Early this year we have entered into an agreement with George Mason University, School of Public Policy to help conduct this report.

We plan on gaging the opinion of a broad range of stakeholders, seeking their input. Other plans on the Commission's agenda include possible field hearings in order to go outside the Beltway. We have established a good precedent with that.

Last year we had field hearings on the development of our new regulatory system and service standards so we would like to build upon that past progress. Hopefully field hearings will aid the Commission as it decides what our recommendations will be.

The law also requires us to consult with the Postal Service on this. At our last monthly meeting, it was raised. I know our staffs have been meeting on this, and I want to again thank General Potter for his cooperation.

It is important that we receive the best information available before we move forward and make any recommendations to the Congress. I know the Postal Service has engaged the National Academies of Science, a very prestigious body, to look into some of the similar issues. To Mr. Potter's credit, he has granted us the ability to have the benefit of that report before we make our recommendations.

I see it as a very broad ranging and a full-bodied report. I look forward to engaging stakeholders. We are still in the formulative plan of how we are engaging in outreach. For instance, on my agenda tomorrow is to talk about the field hearings and potential locations.

We may be holding some other kind of stakeholder input as well, on our contract, or will be gauging public opinion on that. We have a 360-degree front on this in reaching out to as many possible peo-

ple in order to really generate good public opinion so we can make some thoughtful, substantive recommendations to the Congress.

Senator AKAKA. You mentioned that you will be using contractors. What role would these contractors have?

Mr. BLAIR. These contractors will be playing an advisory role, and I appreciate that question too because we have heard that some people view this as a one contractor study. This is the Commission study and the Commission will be making these recommendations. We will be looking at the in-put that the contractor provides. We have an excellent project manager from George Mason. Her name is Dr. Christine Pommerening, and she is going to be tapping into many of the most formative minds in the postal field in the country. But the recommendations and the input that they provide to us will help us. But at the end of the day, these will be the Commission's recommendations. So I appreciate your allowing me to put that on the record as well.

Senator AKAKA. Thank you. Thank very much.

General Potter, currently about a dozen States are looking at legislation to create so-called do-not-mail registries requiring that the Postal Service do not deliver certain kinds of commercial mail to residents.

Does the Postal Service believe that States have the authority to implement rules affecting the mail and would you challenge any such rules?

Mr. POTTER. Senator, we are analyzing that very question, and I do not have a definitive answer for you on whether or not States have that authority. But I will tell you that we are working hard to inform people about the role that mail plans in the economy, both as an employer of millions of Americans as well as a generator of sales and fortunately so far no legislation at the State level has passed and I think once people look at the issue in its entirety the case against that type of legislation is pretty compelling, and so particularly given the state of current economy, I would hesitate to recommend anything that could hurt any State's economy.

Senator AKAKA. Yes. Well, I understand in closing there are 11 States looking into this, and Hawaii is, I think, one of them. But I just wanted your thoughts on that. Thank you very much, Mr. Chairman.

Senator CARPER. Thank you, Senator Akaka.

As you know, Mr. Blair, there have been some questions for awhile about the fairness of the work sharing discounts that the Postal Service offers to mailers who do some of the processing of their mail themselves before turning it over to the Postal Service.

One or two of the postal unions have argued that a number of these discounts are excessive and actually hurt the Postal Service rather than making it more efficient.

There is a provision in the Postal Reform Bill that seeks to ensure that work sharing discounts make more sense. What role do you plan to have the Postal Regulatory Commission take in examining discounts to ensure that they are appropriate and fair?

Mr. BLAIR. Our new rules are cognizant of that special provision within the PAEA. What we are requiring is that a notice of rate adjustment, such as that recently filed by the Postal Service, in-

clude a schedule of workshare discounts and also a separate justification of any discounts that exceed the avoided cost.

The legislation specifically prohibits, except for some exceptions, workshare discounts that would exceed the cost that the USPS could avoid in doing the work itself.

Last week we asked the Postal Service to respond to an information request to explain several workshare discounts that appeared to exceed the 100 percent pass-through level. The Postal Service responded to that request last night. We are examining that but we are very aware of that provision and intend to follow it to meet the intent of the legislation.

Senator CARPER. When you look at the postal reform legislation that we worked on and enacted over a year ago and you look at the provisions that are proving to be positive and especially beneficial, what might be several of those? And you alluded to this at least in part in your responses.

If you had to do it over again or if we had to do it over again, 1 year into this experiment, 1 year into this test drive, what would you suggest we maybe would have done differently?

Mr. Blair, why don't you go ahead and take it and then we will ask the Postmaster General to respond? So a little of each, what things are especially positive in the legislation, and if we had to do it over again, what would you suggest we do differently?

Mr. BLAIR. I think the legislation fundamentally shifted the focus of the relationship between the Postal Service and the regulator. Before it was almost adversarial and the new legislation removed the excessive, lengthy litigation that took place during the rate case. I think that is a positive aspect. It allowed for a more modern rate making procedure to be implemented, and it also required continuing dialog between the regulator and the regulated entity.

I think that is vitally important. I think that over the course of the past year that has worked very well and I am very pleased with that.

I think we saw with the last rate case all the flaws and blemishes that that system brought with it. Congress was very wise in passing the legislation when it did.

Moreover, I know the community backed us up when we said we wanted to get these regulations out sooner rather than later. The Postal Service was a partner in this procedure, which worked incredibly well too.

Regarding what changes might take place in the future, we are only a year into this, and I want to see how well the legislation works. The Commission probably had at least three dozen action items that it had to accomplish. Some had timeframes. Some did not. We have been focusing primarily on the ones with timeframes.

But one of the timeframes is that we have to come up with several studies over the course of the next few years. One is the universal service obligation. One is a 5-year review. One is a 10-year review.

I think we will be in a better position to answer your question in a year or two or three. But so far the system is working, and I think it is working better than most people expected.

Maybe that is from a biased view point. It is hard for me to separate myself from the Commission, and the two view points tend to

be one and the same. But from my perspective, it is working better than I had hoped or had expected.

Senator CARPER. Thank you. General Potter, what do you think is working especially well and a couple of items that you want to flag for us to follow for the future?

Mr. POTTER. Well, I think there are a couple elements of the law that helped us immediately and that is obviously the pricing flexibility that we have in terms of, first of all, the frequency of adjustments and the speed to make adjustments so we are able to change our mailing services prices on an annual basis.

I think the rate cap is going to be helpful because it will keep people in the mail and it is going to create a dynamic ??? that forces the Postal Service to step up to efficiency as well as give people predictability about their rates going forward.

So as you said earlier, people have choices about whether or not they are going to use the mail as their channel or electronic or some other means to send messages and advertisements. So the fact, there is predictability going forward, I think it is very valuable.

In terms of what I think going forward would be helpful to the Postal Service, I think that, if anything, there is not enough flexibility in the law. When I look at the list of products that are on the market dominant side of the aisle, I think there are probably too many, and things, for example, like——

Senator CARPER. When you say market dominant, does that mean shipping services?

Mr. POTTER. No. Market dominant is mail but it goes beyond mail. It has things like P.O. boxes, money orders, basically anything other than Priority, Express Mail, or international mail, largely our package businesses, is put on the market dominant side of law, and so there are things there that I think need to be reevaluated. There are some package services that are on the market dominant side of the law that really should be on the competitive side and allow us to compete.

I think that there are a lot of restrictions around what we can sell and not sell, and when I look around the world and look at other posts, they have the same challenges that we do when it comes to diversion of hard copy product to electronic medium.

And they look at their assets and have been able to get from their governments the flexibility to use those assets to generate revenue to support the universal service obligation that Mr. Blair just spoke about that he is doing a study on.

So when you look at the posts around the world, many of them are using their retail outlets as banks. They do not necessarily own the bank but they provide banking transactions for banks in their countries or in some cases they own the bank.

That type of flexibility is something, I think, that we need to explore because we do have these assets. We are very restricted today in terms of what we can do with those assets. I believe going forward that in order to continue to provide access to mail through those brick and mortar structures that we have, we have to figure out how to generate revenue, other revenue in that location, whether that is services that we provide, and our clerks provide, or leas-

ing out the space so that it generates revenue to contribute to the maintenance of an access point for America.

Senator CARPER. I am going to yield to Senator Akaka. When we come back, I want to explore with you some of the things that the Postal Service is doing in this first year since the enactment of the legislation, and as our economy has slowed, what you are doing to try to shore up revenues and also what you are doing to take costs out of the system.

Senator Akaka.

Senator AKAKA. Thank very much, Mr. Chairman.

General Potter, as you well know, the Postal Service offers a wide variety of products and services to businesses and individuals that often are competitive with your private sector counterparts such as UPS and FedEx.

Here on the Hill, we receive press releases and briefings regarding these services. The Postal Service's competitors spend billions on marketing and advertising their services. I am concerned that the Postal Service may not be marketing as aggressively as the competition.

What kind of commitment does the Postal Service have to building its so-called brand and what can be done to better promote its competitive products?

Mr. POTTER. Well, that is a great question, and I can talk for probably 20 minutes about what we are planning to do.

First, let me say that we do advertise. We spend just under $100 million a year on advertizing. We have not been as aggressive on advertising our competitive products because until we had the new regulations that my good friend, Mr. Blair, put in place, we did not really have pricing flexibility, and in the marketplace when you cannot go out to people who mail any kind of significant volume with an offer, an ability to negotiate, you are really hamstrung.

So our efforts in the past couple of years have really focused on consumers and offering them access and small businesses access to the Postal Service. So we have, now consumers and small businesses have the opportunity to go online to pay for postage. Our carriers go by their door everyday. In the course of their rounds, they can tell us that they have a package to be picked up and so we offer that pickup service as they go by those deliveries.

So the notion of getting online, paying for packages and providing pickup is something that really has helped our business grow.

We also built with Priority Mail: We created a flat rate box and again using the pricing freedoms that we have had, we just created a larger flat rate box, and it was largely as a result of inquiries from military families because it became very popular to use that box to send, I guess, messages, goods, reminders of home to our troops, and so we created a larger flat rate box that we would not have been able to go to market with as quickly as we did if it were not for the new law.

In fact, I just came from the House where we had an effort that was put on by the House caucus that is a part of the America Supports You program, and the Department of Defense has this America Supports You where we demonstrated that we have a new box

that is co-branded and we provide a discount to military families. So they have $2 off on that box that is going overseas.

So we are making strides. I just described in my testimony that we are going to change rates in May for our competitive or package products. At that time, we are going to go out and we are going to offer different prices, a different price for retail than if you go online and buy services.

We are going to, for the first time ever, offer volume discounts for our Express Mail, Priority Mail, and our ground packages. At that point, we are going to launch a major campaign because, again, we will have the flexibility to do it. We are working with the Postal Regulatory Commission and staff, as Mr. Blair said, in a co-operative way.

We are now exploring how we can do contracts with businesses so we will have published prices that we are going to get the Board of Governor's approval on so I am not at liberty to say what they are. But once we have their approval, we intend to file that with the Commission such that we will be able to raise those rates in May and we will have a full campaign on that.

We are probably very unusual in that we are positioned to have a campaign like no other in the sense that people do advertising to move awareness of products and services up. Well, we have 800,000 people who work for us. So our first campaign is to make them aware of our products.

I am really proud of the efforts that our unions are putting forth. We have met with them. They agree that they are going to have to encourage their people to make sure that customers who come into our lobbies are informed about our products, that the carriers on the streets are there making people aware of the products and services that we have, and the new pricing schedules that we are going to put in place. We are going to have an all-out blitz too. We are going to hit a button and 700,000 of our best customers are going to get information on this. We are going to use every channel that we have.

We have nine million Americans that walk into our lobbies everyday. We will have lobby posters. The bottom line is with the new flexibility we have and when we first have an opportunity to use it, that is when we are going to go out in a very structured way, using all of our resources with the help of all of our employees to let America know that the Postal Service has great products to offer. They have good prices, competitive prices, and so that will be kind of the launch of our effort to grow the package business.

Again you want to sell it when you have something to offer. You do not sell it in advance of that. So again you will see a very coordinated effort to go after this.

Senator AKAKA. Thank you. I am glad you are moving on that.

Mr. Blair, last year before this Committee I asked you about PRC's involvement in creating modern service standards for the Postal Service. The Reform Act required the Postal Service develop these standards in consultation with the PRC.

Now that these standards have been issued, what is the PRC's assessment of the overall process and the level of consultation?

Mr. BLAIR. Senator, I think the process worked relatively well. It brought our two sides to the table to discuss a wide variety and

a wide range of issues. We did not always agree. They did not always accept our proposals. But at the end of the day, I believe that our input produced results and a better product in terms of the standards.

We argued hard for greater granularity in their reporting, that it be done by district and that it be done by quarter. Our proposals were the final work product that the Postal Service put out.

I think the consultations produced a good product and we are continuing those consultations. The law also requires that we consult on the development of goals to meet those standards because without goals the standards themselves become de facto goals. We are in that process.

We also have to consult with them on the rationalization of their network, and we look forward to discussing that with them at the upcoming consultations as well.

We are also in the process of reviewing a proposal by the Postal Service on the measurement system that is going to be used. The law granted the Commission the authority to allow the Postal Service to use an internal measurement system. We thought it was in the best interest of the Postal Service and the mailing community, and we are reviewing a proposal that they have put forth based on the intelligent mail barcode at this time.

So I think overall the consultations have been a positive influence on both organizations. It has led to greater dialog between the regulator and the regulated entity. While there may be tension from time to time between the two bodies, I think that is intended by the statute and I think that is healthy. I certainly do not think an adversarial relationship is good, and I am proud to say that I do not think we have one. I think that these consultations have morphed into something bigger and it is a good way of communicating between the two bodies.

Senator AKAKA. Thank you very much for that. I have one more question.

General Potter, the Postal Service offers a wide variety of extra services for different classes of mail such as registered mail and delivery conformation.

However, there are over half a dozen forms depending on the specific services you want. For example, if you want to send registered mail with a return receipt, you have to fill out two separate forms. Some of the competitors offer similar services in a much easier manner by using a single form.

Are there any efforts underway to make the various mail services more user friendly in order to keep up with your competitors?

Mr. POTTER. Yes, Senator, there are. The intelligent mail barcode that Mr. Blair just spoke of is our effort to put one barcode on our mail that would have all the information embedded in it that today are covered in multiple barcodes and multiple requests.

So this barcode will identify the sender, and the destination. It will identify any special service that is requested along with that letter or package that will be put into the mail.

So, yes, we are working on it and we know we have an opportunity to improve and we have people that have been tasked to do that, and there is a lot of communication between the Postal Service and its customer base, and looking to make sure that, as we do

this, we recognize that major changes will not only occur within the Postal Service's system but in customer systems as well.

So we are trying to figure out how to make this transition to an environment you describe in a way that works for all.

Senator AKAKA. Thank you so much for your responses. I really appreciate what you are doing and am happy to hear those responses. Thank you very much.

Senator CARPER. Senator Akaka, thank you very much for being a part of putting the legislation together and for making sure we are appropriately exercising our oversight.

I indicated before Senator Akaka began his questions that I want to come back and just revisit a couple of issues. This will be brief.

But, General Potter, you just talked to us about some of the things that you are doing collectively at the Postal Service, given dropping revenues, some things that you are doing to avoid a $2 billion operating deficit this year.

I know one of those is going for the one-cent increase in First-Class postage which kicks in in May. I think you said that is worth maybe $700 million in this fiscal year?

Mr. POTTER. Yes, it is. So we are making a price adjustment in May that will be conformed to the rate cap obligations.

Senator CARPER. Do you do any modeling, I presume in your projections, to figure out what kind of drop-off, if we raise prices, usually there is some drop-off in demand. Any idea? I realize it is what, 2 or 2.5 percent? It is not all that much. Is there any correlation there?

Mr. POTTER. Yes. Because it is at the rate of inflation, we do not expect the type of drop-off that we saw last year when we had rates that rose above the rate of inflation.

So it is kind of a nominal thing. There will be some drop-off but elasticities will not kick in since it is just at or even now running slightly below the rate of inflation because inflation has continued to move along and we used a January look-back. So we expect a slight drop-off but not much.

In addition to that, I described some of the things that we are going to do and the effort that we are going to make to increase the amount of packages that we have in the system and make sure that people understand the value of not only the package services that the Postal Service provides as well as the value of hard copy versus other choices that they have in the marketplace.

We are looking to try to figure out to make it easier to use, to Senator Akaka's point, not only to use our forms and get around forms and simplify them but also to make access to the mail easier.

So oftentimes people who are trying to do small advertising campaigns find that the process of dealing with the Postal Service and suppliers, whether that is printer or a list provider, is complicated. So we are looking to try and find solutions that will work for those folks as well.

And as we said earlier, our projection for volume is down. So the first thing you do when you have projection of volume below planned is you go back and you adjust the plan's use of resources. So as volume diminishes, your need for work hours to process that mail diminishes as well.

We are also in the process of mapping all of our operations. So looking at the entire value chain throughout our entire system each time something is handled and any time it is handled, we are asking the question of ourselves now is what is the value added by that touch.

So as an example, one of the things that we have historically done is as mail is brought into our plants, we weigh it. And we now have enough mail that the bulk of our mail moves from the dock—it used to move to a scale and then right onto a machine that counted the mail.

It continues to move onto machines that count the mail, and so we are now eliminating weighing of mail. It may sound like something trivial but in the Postal Service, given our size, our scale, scope, it is $100 million worth of costs that can be eliminated. So those kinds of things that we are taking a good, hard look at to determine whether or not they add value.

And in addition to that, we have a program that looks at productivity and measures productivity across the country, establishes goals for people that are consistent with the top quartile of the country.

If one section of the country can get a high level of productivity at one plant, we would like everyone to replicate that and we provide training materials to folks and establish goals.

So it is a continuous improvement-like program and it is paying big dividends for us. So to make a long story short, we are looking at making a price adjustment. We are looking at selling our products and doing it a little more aggressively than we have in the past and we are looking at all our costs to determine, first of all, are there things that we do today that just are not adding value, and second, the things that we do do can we do it better and incent people to do it and train folks to do it?

Senator CARPER. Mr. Blair, anything you want to add or take away from that list for us from your own perspective? I realize this is not part of your responsibilities but——

Mr. BLAIR. Well, not at this point.

Senator CARPER. OK. Fair enough.

General Potter, one of the things that was very important to the postal customers that we met with when we were crafting our postal reform legislation was predictability and that was especially important for business mailers. They wanted to have a much better sense of when prices would go up and by how much.

And you have spoken to this indirectly at least. How you think our new approach, your new approach, to pricing is better? Do you believe it is better than it was in the past with respect to predictability for businesses? And what kind of feedback are you hearing?

Mr. POTTER. Well, I believe it certainly is better and I think that the fact that they now know that we are going to make price adjustments every May. Those price adjustments are capped at the rate of inflation for mailing services. I think that helps them in terms of their own budgeting.

It also helps with investments. There are a lot of folks who had some concerns about where the mail, where the Postal Service was going in terms of prices, long-term and were afraid of increases much above the rate of inflation.

And so the fact that they now can look forward and pretty much predict that they are going to get annual adjustments at or about the rate of inflation enables them, with some surety, to look at what returns they might have on investments that they make in equipment or investments that they might make in longer term game plans around advertising or channel use, in terms of developing relationships with customers.

So the bottom line is I think it has helped businesses and that is the feedback I have been getting.

Senator CARPER. But after the most recent postal pricing changes went into effect, we heard, and I guess you did too, some complaints from certain groups of mailers such as low circulation magazines and some of the catalogs about the fairness of the new prices. Many believe that the final prices worked out after months of negotiation and testimony before the Postal Regulatory Commission may have gone a little too far at least in their minds. I understand that the new prices even had a negative impact or may have had a negative impact on volume at the end of the day.

What, if anything, Mr. Potter, are you all doing in the planned May pricing changes or in future moves, to address the issues mailers had with the last set of changes?

Mr. POTTER. Let me address specifically the two concerns that you mentioned. One was the catalog mailers, and so our pricing, the prices that we set forth and are being evaluated now by the PRC are lower for catalogs and that is a reflection of our concern about hitting them once again. So their rates are below the rate of inflation, the ones that we have proposed.

When it comes to magazines and periodicals, we basically did an across-the-board rate change. We have proposed an across-the-board change. That reflects the fact that there was great complexity in the periodical rate change the last year.

As you know, we had to delay the implementation because there was quite a bit of programming that needed to take place because of the changes that were made ultimately in the rates. So, we basically did an across-the-board rate change again and in deference to the community, so as not to burden them once again with complexity.

We are and do take into account, the different industries and where they are going. I believe that the new law gives us flexibility that will enable us to respond to the needs of the industry and the opportunity to incent different mailers to mail.

So I think we are just beginning to scratch the surface on what we can do under the new law on the mailing side of the house and we are cognizant of the concerns that were raised with the last rate change and we think our proposed rates reflect and are sensitive to those needs.

Senator CARPER. Mr. Blair, do you want to add anything to that please?

Mr. BLAIR. What I wanted to say was, especially under the old system, anytime you had an increase in rates, a decrease in volume was naturally expected. The economic slowdown compounded that situation that you referred to.

The decision in the last rate case was based on 2005 data which was based upon data that was produced months, if not years, ear-

lier. Maybe more rosy economic scenarios were envisioned. However, it came out in 2006, and I think the rate increase, compounded with an economic slowdown, hit some mailers particularly hard.

Regarding the catalogs and flat rates recommendations, it was a zero-sum game. Had catalog rates not gone up, which was an attempt to address an allocation of institutional burden between mailers within the same class, it would have caused letter rates to go up.

It was that bubble. If you pushed it down here, it went up there. We have seen it in the comments before the Commission on this new rate adjustment, that some do not think that flat rates again should have gone up further in order to redress that issue.

I think we are out of that paradigm in these rate adjustment cases. But it goes to show you that old habits die hard. I think the new system ensures that rates, at the class level, will not exceed the inflationary cap and that there will be predictability and stability in rates and that mailers will have a better sense of what those rate increases will be. I think what the Postmaster General just said about increases every May that is going to be worked into mailers business assumptions. I think that we will know now as to what those rate increases will likely be.

Senator CARPER. Thank you. I would like to ask each of you a question or two regarding negotiated service agreements and we will just start off, Mr. Blair, with you.

You will recall that another provision in the Postal Reform Bill that we adopted codifies the Postal Service's authority to enter into negotiated service agreements with individual mailers.

The Postal Service has entered into these kinds of agreements in the past, I believe, with varying degrees of success. None of the agreements, though, to my knowledge, have been a complete failure but I do not think that there have been a lot of them that have brought in substantial amounts of volume and revenue either. If I stand to be corrected, feel free to correct me.

Mr. Blair, first of all, what is your understanding of the Postal Service's authority to enter into negotiated service agreements, and then to follow up, what is your assessment of the Postal Service's ability to negotiate quality agreements that can have a real impact on volume and a real impact on revenue and on the overall efficiency of the Postal Service?

Mr. BLAIR. I think the new rules grant them a tremendous amount of new flexibility that was not there before. The legislation codified negotiated service agreements. It said that it either has to improve the net financial status of the Postal Service or improve operational efficiencies and cause no undue market harm from market dominant products.

And in the competitive areas, you have to cover attributable costs. I think that gives the Postal Service tremendous flexibility in that area.

I agree that the agreements have not been as successful as parties had hoped. I think that codifying this in statute bolsters the Postal Service's negotiating position because parties know what the Postal Service has to do in order to comply with the law.

We would expect more NSAs to be coming down the pike. We have had some preliminary discussions about what they want to do in the competitive arena. We are heartened by that.

We want to make sure that the agreements comport with the law. I think that you would want us to do no less. But I think that this is a new era, and I think we have to look at things a little bit differently. We certainly want to do that. We want to see them succeed.

But we are mindful of our statutory duties. It is a balancing act, and we want to make sure that we walk that fine line.

Senator CARPER. Thank you. Just to close out on this particular topic, General Potter, what lessons have you and your team learned from some of your experiences with negotiated service agreements in the past, including, I guess, the recent experience with Bank of America where the quality of the data that you were using was called into question?

Mr. POTTER. Well, the one thing that I have learned is negotiated service agreements go back to the law. The market dominant or mail side of the house are extremely difficult.

In a sense it is somewhat of a zero sum game, and I think under the old law, the litmus test for it was much more difficult because of the fact that you had everybody looking over each other's shoulder.

The fact of the matter is I am very enthused about the types of discussions that we are having today. When it comes to competitive products, I think we have a real opportunity to grow the business and we have had some very constructive dialog with the PRC and I am anxious to move ahead with it.

On the market dominant side of the house, we are a little more tenuous in terms of how we might do that. We are anxious to get ahead. We have further discussions planned with the Postal Regulatory Commission. We have began having dialog with our customer base.

But under the old rules, it was very easy to throw a stone. I think we are going to have to change the mind set of folks to say, gee, it might make sense to charge somebody a lesser price if it is a matter of retaining business that makes some contribution to the bottom line.

It might make sense to incent people to go into new markets to advertise. These are concepts that are foreign to our old way of doing business and are things that we are going to have to explore and do it in a very deliberate way in order to reassure the community that there are sound reasons to move ahead.

That being said, I agreed with what Mr. Blair said, the new law, the litmus test, or the hurdle that you have to get over under the new law is quite lower than it was under the old law, and the process—thanks to the new regulations that they would have put out for rates in general and what we anticipate they will do with negotiated service agreements—will be much more expeditious and will provide the type of flexibility that I think the law intends.

So I am very anxious about what we are going to do on the competitive side. We are going to call it contracts. Again, I said that early on, we are going to try to use that language so folks that we are dealing with understand it, and on the market dominant side,

we are working hard to find a path and to communicate so that everybody understands what we do and how we do it. And the understanding is it is going to make of the whole better and not necessarily meet the requirements of the old law.

Senator CARPER. All right. Just one more time for my edification, just tell us again the new lingo for market dominant, for competitive.

Mr. POTTER. OK. Mail, or Market dominant products—First-Class Mail, periodicals, Standard Mail—it is now called mailing services.

Competitive products—Express Mail, Priority Mail, international packages—we are now calling that shipping services.

We are not going to use the word "rate" anymore. We are going to use the word "price." We are going to move away from the term "discount," and we are going to talk about incentives for people to mail.

Those are the types of language that we want people to start thinking of us as. You are asking us and have told us that you want us to compete, to operate like a business and so we are going to move to talk like a business.

Senator CARPER. That is probably a good place to end this hearing on. I am glad to hear you are talking the talk.

When I was governor of Delaware—I will close with this thought—I was governor of Delaware. About the mid 1990s we decided to launch welfare reform, and we decided to launch welfare reform as a country, and as it turned out, we ended up launching welfare reform where we limited the amount of time that people would be eligible for welfare benefits. Tried to offer them things that would make work pay more than welfare.

And just by dumb luck, we launched welfare reform in the middle of the longest running economic expansion in history of the country. Enormous job creation was occurring, and it was not that welfare reform was easy but it was a whole lot easier than it would have been otherwise.

It occurs to me that we have launched postal reform at the beginning here of an economic downturn and slow down when it makes a different transition all the more challenging.

I am encouraged that, at this point in time, one year into this, you and the folks you lead are taking the right spirit into a brave new world, and I applaud that. I am encouraged by it.

I realize we just have a year under our belts, a year under your belts, and we are going through a learning process and I am pleased to hear that some of the things we thought might work are for the most part working. Maybe some little better than expected and there are some other problems that may have emerged or some areas to keep an eye on or ones that we just need to watch a bit more.

But that is pretty much what I had to say.

Anybody else have a closing word? Mr. Blair, you looked like you might have something else you want to add.

Mr. BLAIR. I would much rather be having this discussion today than a similar discussion where we are facing a very contentious old cost of service rate case under the old rules had postal reform not passed.

So is it the best environment to implement a reform agenda? Maybe not, but I think it is better than not doing it at all, and so maybe you were prescient in forecasting that this was going to happen and that foresight is going to benefit the system as a whole.

Senator CARPER. I wish I were that smart. In any event we appreciate your being here. We appreciate the spirit that you bring to these challenges, and we look forward again to continuing this dialog both in a forum like this and in less structured forums as well.

Our thanks on behalf of the Subcommittee to each of you and to your respective teams, to your colleagues. Thank you for testifying today and really for your commitment to making postal reform a success.

The hearing record will remain open for, I think, 2 weeks for the submission of additional statements and some additional questions. To the extent that you receive those, I would just ask that you respond to them promptly if you will.

And with that it is 4 o'clock. It is time for us to go vote so this has worked out very well.

Thank you so much.

The hearing is adjourned.

[Whereupon, at 4 p.m., the Subcommittee was adjourned.]

APPENDIX

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

MARCH 5, 2008

Good afternoon, Chairman Carper, Senator Coburn, and members of the Subcommittee. I am pleased to have the opportunity to report to you today on the status of the United States Postal Service as we work with our employees, with our customers, and with other agencies of the federal government to implement the provisions of the Postal Act of 2006.

In testimony before this Subcommittee last year, I discussed the fundamental changes the new law brings to the operation of the Postal Service. These fall into three primary areas: the division of our business into market-dominant and competitive products; new, flexible, and different pricing systems for each of these product groups; and the replacement of a break-even financial requirement with one that permits retained earnings or, simply put, profit.

I believed then, as I believe now, that the new law offers the Postal Service tremendous opportunities. I believe that these opportunities can and will benefit every user of the mail, from the consumer to the small business to each and every part of the world's most advanced and innovative mailing industry – the organizations that rely on the mail as a welcome, efficient, and cost-effective method to connect with their business partners and customers.

Their success is an engine that creates employment, produces and invests revenue, funds the operation of government at every level, and supports local, regional, and national economies – both directly and through closely linked supply chains.

With a network that is – and must remain – capable of reaching 148 million delivery addresses every day – a delivery base that expands by some two million each year – America's postal system is extremely sensitive to fluctuations in the economy, both as they affect us and as they affect mail users.

We are now almost halfway through our first full fiscal year of operation under the new law. In addition to the $5 billion net loss we incurred last year as a result of the transition to the pre-funding of our retiree health benefits obligation, we are facing a potential net loss of over $1 billion this fiscal year. Later in my testimony, I will discuss how we are addressing this challenge.

It is reasonable to ask "how did we get here?" Just one year ago, the Postal Service was developing plans that would build on our successes and take advantage of the new approaches defined by the new law. We had just completed a year marked by record mail volume – more than 213 billion pieces, reflecting the robust condition of the economy. Service was strong. We were preparing to adjust our prices in May to offset a sharp surge in energy and other costs, and to provide incentives for mailers to shift volume to shapes and sizes that our system can process more efficiently. As it had since the Postal Service supplanted the heavily-subsidized Post Office Department in 1971, the average price of a stamp would continue to track inflation.

While a price change often results in short-term mail volume declines, volume returns to – and generally surpasses – previous levels relatively quickly. This was not the case as we ended fiscal year 2007 and moved into fiscal year 2008.

As the pace of economic growth began to slow down late in 2007, mailers compensated by adopting pricing incentives quicker than our plans had anticipated, negatively affecting our revenue projections.

In some ways, the current weak economy has disproportionately affected Postal Service revenue. The financial, credit, and housing sectors are among the key drivers of our business. With recessionary trends in these normally strong sectors, mail volume and revenue began a strong and steady decline. As we approach the mid-point of our fiscal year, we see deterioration continuing, with no signs of improvement.

Tighter credit means less credit prospecting, with offers of credit far more limited than previously. Consumer confidence is down. The recent holiday season registered the weakest retail sales since 2002. And with reduced consumer spending, there is less demand for shipping.

The problems in the mortgage and housing markets have resulted in a slowdown of new construction and a surplus of unsold new homes. With fewer new households, there is less growth opportunity for catalogs, magazines, and other mail.

Since the widespread adoption of the Internet and other electronic communications, their functionality has moved from informational to transactional. This has resulted in a steady erosion of First-Class mail, historically our most profitable product. As the current economic conditions place added pressure on profit margins, we are seeing a growing number of businesses offer incentives and add new charges to increase the rate of conversion to electronic bill presentment and payment.

This has driven a shift in mail usage. Today, Standard Mail – largely catalogs, advertisements, and offers – has supplanted First-Class Mail as our largest product. This has made us far more sensitive to downturns in the economic cycle, as advertising spending is extremely vulnerable to periods of retrenchment. And, while advertising alternatives may not offer mail's advantages, particularly in terms of targeting, personalization, or effectiveness, there are signs that advertisers and marketers, reacting to the economy, are shifting some spending to lower-cost electronic media.

During previous slumps, we could expect advertisers to return to the mail as the economy improved. However, because electronic channels were not available in the past, we expect that some mailers will shift a portion of their spending permanently to these lower-cost media, contributing to the ongoing structural change in mail usage.

We are also facing "Do Not Mail" legislative initiatives in some 15 states. These not only threaten the viability of the mail in and among the affected states; they also undermine our ability to support a national network, one capable of serving every resident of every state, territory, and possession – affordably, effectively, and efficiently. We believe the success of these initiatives will also come at the expense of jobs, the viability of local businesses, and the reduction in municipal, county, and state revenue. We cannot afford these results during the best of times; they are unthinkable when the economy is faltering.

These conditions have had a material and negative effect on our bottom line. Our first quarter, which coincides with the historically busy holiday mailing season, did not record any volume growth. In fact, it was the first time that holiday mail volume was less than that of the previous year.

Overall, mail volume declined by 3 percent, with virtually every product category down. As a result, our revenue was $523 million below plan. Net income fell short of our expectations by $183 million.

First-Class Mail, our largest revenue producer, fell by almost 1 billion pieces, some 4 percent below the same period last year. Standard Mail, which eclipsed First-Class Mail as our largest volume product in 2005, declined by almost 750 million pieces, 2.6 percent less than the first quarter of 2007. There are no current signs of improvement for quarter 2.

Ultimately, less mail volume results in less revenue to support infrastructure. That means higher costs per piece of mail handled. Our fixed delivery costs are the same for bringing one piece of mail to your door as they are for twenty. As the only delivery service provider with a universal service obligation, we cannot offset costs by offsetting service levels.

Our mission is to provide uniform service at a uniform price to everyone, everywhere, every day. This mission does not change, whether the economy is growing or declining. And, because Postal Service operations are not dependent on tax dollars – they are funded by the sale of our products and services – we must carefully manage costs and pursue profitable growth opportunities to maintain the reach and effectiveness of the nation's postal system.
Cost cutting alone will not help us achieve prosperity. Rather, it risks undermining service levels. This, in turn, would diminish confidence in our brand, not only limiting growth opportunities but driving customers to other channels and competitors.

As we faced the fiscal realities of an extremely difficult first quarter, we could not lose sight of these issues. I am pleased to say that the men and women of the Postal Service were up to the challenge. For more than 230 years – during good times and bad – they have demonstrated their grit, professionalism, and commitment to service. The last several months have been no exception.

With less mail coming in, they realigned resources, quickly bringing down spending. They adjusted transportation to match volume. They reduced expenditures for supplies, services, and other non-personnel expenses. They used less overtime and increased the use of seasonal employees, consistent with the provisions of our labor agreements. While they did bring spending considerably below plan, even these reductions could not close the huge revenue gap created by the sudden, steep, and ongoing decline in mail volume.

Those important operational decisions, made in the field and at national headquarters, went beyond the simple exigencies of quarterly financial results. They were also focused on longer term needs. Our people understood that our financial challenges existed separate and apart from customer expectations. If we were not meeting or exceeding those expectations, we risked having customers take their business elsewhere. Only by protecting service – even as we cut costs – could we create an environment that will support growth when the economy begins to recover.

The good news is that we not only met customer expectations, but from a service perspective, we had the strongest first quarter in our history. This is traditionally our most difficult quarter, coinciding with the onset of severe winter weather and the pressures of the holiday mailing season. Independently measured on-time delivery of single-piece First-Class Mail committed for next-day delivery reached 96 percent, two-day mail rose to a record 93 percent, and three-day mail held at a first-quarter high of 88 percent. Two of our 80 field districts achieved an overnight on-time rate of 98 percent; another five scored a 97 percent.

We saw similar progress with remittance mail – largely payments to banks and credit card companies. Bill payments are so time-sensitive that mailers measure our performance in hours, not days. The latest report from Phoenix-Hecht – prepared by the industry for the industry – shows that we reduced two hours from our payment processing and delivery time since the last report, just six months ago. With an economy defined in part by credit problems, delivery speed means more than ever for these customers. Every extra hour they have access to their payments makes a difference to them.

It makes a difference to us, as well. Our speed in delivering these payments, combined with the extraordinary levels of trust Americans have in the mail, can keep us competitive in this market.

In 2007, for the third time in a row, the respected Ponemon Institute has rated the Postal Service as the most trusted government agency and one of the ten most-trusted organizations in the nation – public or private.

This is an extremely important differentiator as consumer concerns about identify theft continue to grow. Amid these concerns, new data collected by the Federal Trade Commission confirm that although there are many sources of identity theft, the mail is, by far, one of the least significant. Only two percent of those surveyed identify the mail as a source of this crime. This reflects the vigilance and effectiveness of the Postal Inspection Service in bringing perpetrators to justice, in serving as a deterrent through their effective investigations, and in participating in education and awareness programs that help consumers protect themselves.

It should come as no surprise that customer satisfaction with the mail remains extremely high – among the highest of many consumer products and services. Ninety-two percent of residential customers rate their experience with the Postal Service as excellent, very good, or good.

These results, also independently measured, were echoed in a recent Roper Poll showing that the American people view their Postal Service more favorably than any other federal agency rated – with almost half reporting that they view us "very favorably". We have held this top position for ten years.

As we reach out to serve the world's markets, we are pleased that by the end of fiscal year 2007, each of our five International Service Centers – in Chicago, New York, San Francisco, Los Angeles, and Miami – received the Certificate of Excellence awarded by the International Post Corporation. These facilities serve as our primary hubs for international mail. The certification is the result of a rigorous, 140-step evaluation process to identify facilities that have achieved the highest standard of mail processing efficiency. The United States Postal Service was the first to be recognized with certification for each of its international facilities.

Not only did our employees deliver the best service ever during 2007, they also made it our safest year, with continuing declines in industrial and motor vehicle accidents. We have developed effective partnerships and agreements with our four major unions and with the Occupational Safety and Health Administration, and they are improving workplace safety. The direct beneficiaries are our employees and their families.

The Postal Service also offers access no other business can match. With 37,000 postal facilities, our retail network is the largest in the nation. More than 45,000 retail partners make postage stamps as convenient as a trip to the supermarket, drug, greeting card, or convenience store. Each of our 77,000 rural delivery routes serves as a Post Office on wheels. Our carriers will pick up packages and mail at your home, your business, and at more than 300,000 blue collection boxes. And just about everything you can do at the Post Office, you can do online, at our website, usps.com – it's the Post Office that never closes.

While our brand is sound and our business, in many ways, is well-positioned to rebound with the economy, even the experts are unsure about the duration or ultimate extent of the current downturn. We are encouraged by the actions of Congress, the White House, and the Federal Reserve in working to strengthen the economy. We believe that a successful stimulus package can create the necessary conditions that will stabilize and contribute to reversing current mail-volume trends.

However, we cannot simply wait for a recovery. We must act now to pursue the strategies that will help us close this year's budget gap. We cannot afford – literally or figuratively – to begin the first year under a price cap system more than $1 billion in the red. We would never be able to dig out of that hole. To avoid this, we are following a two-part strategy: prudent cost management and focused revenue growth.

We have closely reviewed all of our costs and the immediate opportunities for efficiency improvements – at every level of the organization and in operational and administrative functions. We have identified savings of an additional $1 billion dollars over the $1 billion already built into our budget. Our leadership has made a commitment to achieve every penny of the savings identified in their areas. We will meet this goal. And we are clear in our resolve that it will not come at the expense of service.

Just as importantly, the active pursuit of growth must be – and has become – an integral element of our business. We are long past the time when we could expect steady, year-after-year mail volume growth to produce the revenue necessary to pay for a continually expanding network – one that links every family and business in the nation with every other.

The market in which we operate continues to grow more competitive. This means that the Postal Service must become more flexible if it is to remain competitive and successfully meet its obligations to the nation. The Postal Act of 2006 provides us with new tools that are intended to help us do this. This includes new approaches to pricing, intended to foster revenue growth.

Throughout the entire Postal Service, employees recognize that the new law has fundamentally changed the way we do business. They know that revenue growth and profit are necessary to a secure future. They understand that their success is dependent on the organization's success. They realize that operational excellence and customer focus go hand in hand. It cannot be one or the other. It must be both.

Our first full year of operation under the provisions of the new law is also the first year of new, multi-year, collective-bargaining agreements with each of our four major unions. This is the first time in a generation that the new agreements have become effective at virtually the same time. This puts all of us on the same starting line, at the same time, prepared to face a challenging new world together.

I appreciate the recent dialogue I have had with union leadership about opportunities for growth and ideas on employee efforts to fully educate our customers on our services. I also have shared with our unions the concepts behind our pricing strategies and sought their input, which has been helpful and valued. Despite this, there are issues such as contracting where differences remain. We are engaged in a constructive dialogue to discuss with the unions possible options regarding delivery services and our processing network.

I am, however, encouraged that the unions and management are in agreement on some of the key issues that are facing us. There is unanimity on the need for growth. There is unanimity on the fact that all of our employees, whatever their jobs, have a role in driving that growth. I am particularly grateful to the presidents of the American Postal Workers Union, the National Association of Letter Carriers, the National Postal Mail Handlers Union, and the National Rural Letter Carriers' Association for their support, encouragement, and ideas in this area.

Our entire team is ready to make the new law work for us and for our nation. We are acting quickly to use its new approaches to produce the revenue that can close the remaining $1 billion of our budget gap. Even though the new law permitted us one final price-adjustment cycle under the provisions of the 1970 law, the inordinate length of that process would not have produced additional revenue before the middle of our next fiscal year. Frankly, we could not afford that.

Neither could our mailers. In our conversations with them, they made it clear their preference was for smaller, regular, and more predictable price changes. This allows them to better plan and budget for mailing expenses, avoiding the "sticker shock" many of them experience when they must absorb larger price increases every two or three years. Consistent with the intention of the new law, we plan to adjust rates each May.

Our decision to adjust rates on May 12 for our market-dominant products – First-Class Mail, Standard Mail, Periodicals, and Package Service – is projected to produce about $735 million in additional revenue through the end of this fiscal year. Prices for these products will increase by an average of 2.9 percent at the class level, conforming to the law's requirement that they not exceed the rate of inflation as measured by the Consumer Price Index.

In some service categories, prices will remain the same or will actually go down. For example, there is no change in the additional-ounce rate for single-piece First-Class Mail. There is a new, lower additional-ounce price for some presorted First-Class letters. The pound price for Standard Mail saturation and high-density flats will be lower than the current rates. And through the new price structure, we have continued to simplify our international services, aligning them more closely with domestic products, making it easier for customers to select the prices and services that best meet their needs.

The law requires the Postal Service to operate in a more businesslike way than had been possible under the restrictive provisions of the old law. We recognize that pricing innovation – even within the limits of a well-defined rate cap – is a key business driver. With that in mind, we are taking full advantage of our new pricing flexibility to grow business.

We could not have acted so quickly without the diligence of the Postal Regulatory Commission and its Chairman, Dan Blair. Although the law did not call for the Commission to develop new pricing regulations before June 2008, its members made this a priority and worked closely with the mailing community to understand its needs and preferences.

The Commission's completion of this complex and critical task in October, well ahead of schedule, put the Postal Service in a better position to weigh its needs against the new and the old pricing regulations, permitting us to make a decision that will have a significant and positive impact on our bottom line in the current fiscal year.

Taken together, the additional cost reductions of $1 billion, combined with the $735 million in increased revenue from the coming price adjustment, can reduce our projected 2008 loss from $2 billion to $265 million.

We have taken a realistic look at immediate-term growth opportunities, both in core, market-dominant products, and in competitive products – such as Express Mail, Priority Mail, and Parcel Select. We believe that over the next seven months we can and we will exceed the revenue that will be produced by the coming price adjustment and more than meet the $1 billion we have added to our revenue target.

We are now finalizing a new price structure for our competitive products category and expect to announce it sometime next month. Unlike market-dominant products, prices in this category are not linked to the CPI cap and can be aligned more closely with the needs of customers and the dynamics of the marketplace.

In the meantime, we are enhancing our Express Mail and Priority Mail products so they provide even greater customer value. We are expanding the range of the Express Mail guaranteed overnight network to include even more ZIP Code destinations. We are providing additional scanning as Express Mail moves through the network, providing customers with the enhanced tracking information they are requesting.

Unlike similar products offered by competitors, Express Mail offers Saturday delivery at the regular weekday delivery price. And the Postal Service is alone in offering Sunday and holiday delivery of this guaranteed overnight delivery service. The new premium pricing – which matches other shippers Saturday delivery surcharges – reflects the premium delivery option the Postal Service provides on Sundays and holidays. These are services that are not available from other providers at any price.

Responding to the needs of commercial shippers, we have introduced a new, larger Priority Mail Flat-Rate box. We have also made it easier for friends and families to bring a touch of home to their loved ones serving at overseas military addresses with a two-dollar lower price on the new Flat-Rate box. This is a first, something that was not possible under our previous pricing regulations.

We have just scratched the surface of the advantages the new law offers through its new approach to price setting. I have challenged everyone in the organization to bring their ideas to the table. They are responding with energy, with creativity, and with a commitment to making our services the services of choice for every mailer and every shipper.

Our preparations over the last year have also included addressing the multiple new review, policy, and reporting requirements established by the law. Some were the sole responsibility of the Postal Service. For others, we provided cooperation and assistance to the agencies that were assigned primary responsibility.

Soon after the law's enactment, we instituted a new nationwide policy to implement the changes it mandated to the workers' compensation program for employees.

By early spring, we had completed a review and assessment of our existing purchasing regulations. We found that they met the intent of the law as it relates to the use of commercial best practices and fair treatment of suppliers. The law recognizes the positive business value of these approaches to purchasing the supplies and services that support a nationwide mail processing, transportation, and delivery network. Through innovative practices such as national pricing agreements and reverse auctions, we can seek the best value – a combination of price, quality, availability, and service. This helps minimize our costs and limits growth in the price of postage, ultimately benefiting every postal customer in every community. Last year, using these approached, our cost for supplies and services – at $2.6 billion – was $49 million less than the previous year.

Another issue we examined last year was the retention, handling, and release of data that may be relevant to legal and judicial activities. As a result we developed data retention policies that are now standard throughout the organization. These are supported by well-defined procedures that we will follow in response to subpoenas.

The independent Office of Inspector General of the Postal Service submitted its report on workplace safety to the President, Congress, and to Postal Service management. We were extremely pleased by its conclusion that ". . . the Postal Service established and exceeded its OSHA I&I (Injury and Illness) reduction goals . . . ." In November, we provided Congress with our response to this report.

We also reviewed our international operations from the perspective of customs practices. As a result, we have created a plan for the effective implementation of customs requirements throughout the system.

By September, we developed and submitted our initial Mail Classification Schedule to the Postal Regulatory Commission. This was a critical step in the delineation of the distinctions between our market-dominant and competitive products categories.

The requirement that the Postal Service develop modern service standards and the supporting service measurement systems for market-dominant products is among the most far-reaching activities called for in the new law. By November, we provided the Postal Regulatory Commission with an outline of our approach to service measurement, beginning an important conversation on this subject. In December, after months of consultation with the Commission, we published our modern service standards.

The new standards take into account the current capabilities of our mail processing and transportation networks, as well as changes in mailer behavior – such as worksharing and entering mail deeper into the postal system – that can have a material effect on the amount of elapsed time from mailing through delivery. The input of mailers representing virtually every element of the mailing community was an ongoing and integral part of this process. This cooperative effort contributed to the development of service standards that meet the needs of customers as well as the Postal Service.

New service-measurement systems will help drive the achievement of the new service standards when implemented. Through conversation and consultation with the PRC, we have agreed in principle to the creation of a measurement system that joins independent, third-party measurement activities – essentially an expansion of today's independent External First-Class Measurement System – with robust internal measurements made possible through the implementation of the Intelligent Mail Barcode.

The new barcode will become mandatory in 2009 for mailers who take advantage of automation prices. Its use will allow us to combine a system that physically measures a limited, but statistically valid, sampling of our daily mailstream to one that passively measures an exponentially greater volume. For example, in December, with slightly more than 400 mailers participating, we collected more than one-billion Intelligent Mail Barcode scans. During the same period, our external, third-party system measured 250,000 pieces of mail.

The mail-flow data we collect will be the basis for a wide range of reports that customers can obtain and that can also serve as important diagnostic tools for the Postal Service. We believe this system represents the ideal synthesis of both systems – actual performance data measured in real-time as mail moves through our network, plus the validation offered by external sampling.

A second report by the Office of Inspector General, in November, addressed the adequacy and fairness of the Postal Service's process for the determination and appeal of Nonprofit rate mailings. The OIG's report found that "the assessments and appeals process was adequate and fair," and found no compelling reason for Congress to assign an outside body a role in the process. The OIG also determined that there was no need to establish a statute of limitations because of our existing 12-month time limit for revenue deficiency assessments. In the areas where it was recommended that we update and clarify our instructions, we agreed to do so.

The following month, the Postal Service's Board of Governors completed two workplace-diversity reports that were submitted to the President and to Congress. One addressed diversity within our management ranks and the other focused on purchasing contracts with minorities, women and small businesses.

The Board reported that although the total number of Postal Service employees has decreased since 2004, the representation of female and minority employees has increased steadily. Over the three-year period covered by the report, the percentage of Hispanic, Asian American Pacific Islander, Black, and White females in supervisory and managerial positions has increased.

The Board was also clear about its ongoing commitment to building strong relationships with small, minority-owned, and women-owned businesses. This commitment is reflected in the creation of a new *Supplier Diversity Corporate Plan – Fiscal Years 2007-2010*, which underlines the fact that supplier diversity is a proactive business process with the goal of providing suppliers with access to purchasing and business opportunities. The number and value of these contracts are tracked quarterly and annually, with sourcing and commodity strategies adjusted as necessary. In fiscal year 2007, the combined value of contracts with small businesses, minority-owned businesses, and women-owned businesses was $4.4 billion.

In recognition of our efforts to establish and maintain a strong, competitive supplier base that reflects the diversity of the supplier community, DiversityBusiness.com named the Postal Service as the Top Organization for Multicultural Business Opportunities and one of America's top diversity advocates.

Also in December, the Department of the Treasury submitted its recommendations to the Postal Regulatory Commission on the accounting practices and principles that will be used to separately account for our market-dominant and competitive products.

The Treasury's recommendations addressed our cost-attribution systems; the creation of a theoretical Postal Service competitive enterprise; the creation of a corresponding theoretical income statement using existing financial systems; attributable costs and cross-subsidization; the validation and adjustment of the costs of our universal service obligation; line-of-business costs and institutional costs; the use of a simplified approach for calculating federal income tax; and, sufficient independent review of supporting information.

Our review of the Treasury's recommendations indicates that they are consistent with our approaches to these issues. When completed and implemented, they will provide for a full and fair accounting for all costs and prevent any financial cross-subsidization of competitive products by market-dominant products.

At the same time, the Government Accountability Office issued an interim report to Congress on Postal Service and mailing industry mail-related recycling. The report found that the Postal Service, the mailing industry, and other stakeholders have undertaken numerous mail-related recycling programs, but could not quantify the extent to which these initiatives have been undertaken. The report lists several innovative stakeholder-identified opportunities to enhance recycling efforts but cautions that they must be considered within the context of mission compatibility, logistics, and cost. The GAO expects to issue a more comprehensive report in the spring.

In the meantime, the Postal Service will continue to plan, execute, and improve programs – internally and with industry partners – to minimize the impact of the mail and postal operations on every aspect of the environment. It is our goal to be a positive environmental influence in every community that the Postal Service calls home. Our investments in recycling, energy conservation, "green" vehicles, and "green" buildings continue to be recognized as innovative and effective. For the Postal Service, sustainability is more than just a concept – we are making it a way of life.

We submitted the initial version of our Annual Compliance Report to the Postal Regulatory Commission in late December. It includes data on product costing methodologies, service performance, and customer satisfaction. Because the Report covers fiscal year 2007, it is largely transitional in nature, as price setting during that period was governed by the provisions of the Postal Reorganization Act of 1970, not the Postal Act of 2006. Similarly, data contained in the report is primarily based on what has been filed in the past, in accordance with the requirements of the 1970 law.

As the Commission completes its rulemaking addressing the Annual Compliance Report, we make appropriate adjustments to its content and the sources of information that we will use. We anticipate filing our first official Annual Compliance Report this December.

Among the significant changes resulting from the new law is the requirement that the Postal Service comply with Securities and Exchange Commission rules that implement the financial internal controls under Section 404 of the Sarbanes-Oxley Act of 2002. We must also obtain an opinion regarding the effectiveness of Internal Controls over Financial Reporting from the Board of Governors' external audit firm. The Postal Service is the only federal agency with this obligation and we are on track to meet full compliance requirements by 2010.

To prepare for this, the Postal Service is following best practices and guidance published by the Public Company Accounting Oversight Board (PCAOB) and the Securities and Exchange Commission (SEC) We have established a top-down, risk-based approach to identifying, assessing, and reporting internal controls that can affect our financial reporting. We are also using the framework established by the Committee of Sponsoring Organizations, and which is approved by the SEC and PCAOB, to assess the key components of our internal controls.

In 2007, we achieved several key milestones in complying with the Sarbanes-Oxley requirements. We identified the systems and financial business processes that will fall within the scope of our efforts. We established an active SOX Steering Committee and Program Management Office. We targeted opportunities for business process improvements. And we are evaluating and assessing the key internal controls over financial reporting, allowing us to identify and resolve any discrepancies.

Earlier this month, we filed our first 10-Q Quarterly Financial Report with the Postal Regulatory Commission. Regular quarterly reports will follow, beginning in May. We will file our first 10-K Annual Financial Report in November.

Over the years, there has been considerable discussion about whether the Postal Service's status as a government organization provides us with an advantage – or a disadvantage – in the competitive marketplace. In an effort to provide a quantitative answer to this question, the new law directed the Federal Trade Commission to prepare a report regarding the federal and State laws that apply differently to the Postal Service than to the private companies that provide services similar to those in our competitive products category.

The FTC's study was far reaching and detailed, including input from the Postal Service, leading private-sector delivery companies, the Postal Regulatory Commission, Government Accountability Office, other government agencies, mailers, postal unions, and members of the public. In examining economic burdens compared to what it terms "implicit subsidies," the report concluded that the Postal Service is burdened with a unique "net competitive disadvantage versus private carriers." This is based on the costs of meeting our universal service obligation, as well as other laws and regulations that apply to the Postal Service but not to other carriers. The report estimates that these differences incur costs on the Postal Service that may exceed $550 million a year.

As I mentioned earlier, we will be implementing our first price changes using the new regulations on May 12. In the market-dominant product category, we have set prices carefully to satisfy the requirements of the law and to moderate the impact of the 2007 price changes for Standard Mail flats and Periodicals. Our proposed prices for these products, as filed with the former Postal Rate Commission in 2006, were in many cases less complex and below those recommended by the Commission in its decision of February 2007.

An important milestone established by the new law is the requirement that the Postal Regulatory Commission prepare a report on the Postal Service's Universal Service Obligation and the mail monopoly by the end of this year. These are important public policy questions that have been a rich source of study, conversation, and debate over the last several years.

The consequences of any proposals to modify our universal service obligation will be profound for every family and every business in every community throughout the nation. I believe the Commission's assignment – and the interests of the American people – can only be enhanced by its review and consideration of the existing body of work in these areas. On behalf of the Postal Service, we look forward to working with the Commission as it undertakes this important task.

Over the course of this year, the Postal Service will continue to break new ground as it implements innovative pricing structures for our competitive product category. They will reflect the flexible approaches now available through the new law and we expect to be announcing them soon. Our efforts are intended to make these products more attractive by providing shippers with incentives and other approaches that are common throughout the shipping industry, and that we have designed to support growth and profitability.

In many ways, the potential for growth remains largely within our control. It will be dependent on continued strong service, easy and convenient access, products that meet today's customer needs and anticipate those of tomorrow, the effective use of new pricing tools, and, of course, effective marketing and sales efforts – formal and informal – by every one of our employees in every part of our organization.

As we align our efforts with the regulations developed by the Postal Regulatory Commission, we need to continue to work with the Commission to ensure that the new regulations do not unnecessarily impede our ability to negotiate customized pricing and service arrangements with individual mailers – both in the market-dominant and competitive product categories. The intent of the new law was to remove the barriers that prevented the Postal Service from going to market quickly. But the prospect of an open-ended regulatory proceeding before any customized agreements could become effective can create uncertainty in the minds of our customers as to our ability to negotiate agreements that can, ultimately, be implemented.

An additional issue with this procedure is maintaining the confidentiality of the terms of a specific agreement – a common practice throughout today's business world. We are hopeful that we can continue to work with the Commission to resolve these issues in such a way as to fully capture the potential for creative and profitable customer arrangements embodied in the new postal law.

In pursuing growth, we also see tremendous opportunity in international products. We have improved our network, simplified product offerings, and made it easier for mailers to navigate complex customs and other processes that have served as impediments to expansion in the past. We appreciate the cooperation of our partners – other federal agencies, foreign postal administrations, the International Post Corporation, and the Universal Postal Union – in helping us to create an environment that supports the efforts of American businesses, large and small, to take advantage of international markets.

While we have benefited from changes in foreign exchange rates – a situation we cannot depend on in the long term – it is no surprise that good service sells. Our international mail volume has grown by 18 percent over the last two years. We are working to position ourselves to continue strong growth in this product line.

Overall, the outlook for our international products is encouraging. Yet there are a number of situations that do cause us concern that we cannot resolve independently.

The first of these involves international air transportation. Today, the rates we pay air carriers for this service are governed by Department of Transportation regulations. Generally, we cannot negotiate rates based on market conditions, volumes, performance or other variables that are taken for granted in negotiating rates for the ground and air transportation of domestic mail.

Put in its simplest terms, a law that requires us to move toward even more businesslike management practices has placed us at odds with another law that, in this instance, prevents it. As we begin operations under a price cap that affects the lion's share of our business, we must find ways to reduce these and other costs.

We must also consider their effect on the customers who ultimately bear these costs. For example, the Department of Defense, one of the largest volume users of international air transportation for mail to APO and FPO addresses could have saved some $200 million over the last decade had we been able to negotiate with carriers. As we consider the needs of our national defense and the men and women of our armed forces – particularly during this time of conflict, it appears clear that this money could have been far better spent.

We have been discussing this issue with a number of air carriers and are hopeful that we can reach a consensus that supports the change to a negotiated rates solution. With such a system in place, the Postal Service could have benefited from approximately $500 million in cost avoidance over the last 10 years.

This limitation can only be removed through the efforts of Congress in introducing and enacting legislation that would permit negotiated rates for international air transportation.

A second issue of concern regarding international mail involves the entry of material generated by American businesses or government agencies directly into the mailstreams of foreign postal administrations. For example, an American business may prepare a mailing for customers or potential customers with addresses in Mexico. The originator would bypass the United States Postal Service and work through a third party to pay Mexican postage and deposit the mail through Mexico's Post Office.

The third parties can be other foreign posts, such as Germany's Deutsche Post, or private businesses that maintain a presence in Mexico or other nations for this purpose. When the third party is another postal administration, this type of office is known as an Extraterritorial Office of Exchange (ETOE). This is a legitimate practice and one sanctioned by the Universal Postal Union.

Unfortunately, our experience has shown that the activities of some foreign posts and consolidators can result – inadvertently or otherwise – in lost revenue and increased costs for the United States Postal Service.

This often occurs when material entered through foreign posts is returned to its American originator through our mail system because it is undeliverable as addressed. However, because it did not originate as United States mail with United States postage, we incur added costs for its return. The actual mailer, the foreign-based ETOE or consolidator, should be the recipient of the returned mail and responsible for its costs.

But in many instances, the return address on the mailpiece identifies only the originator of the mail in the United States, not the actual sender, incorrectly leading to the assumption that the item began its journey as U.S. Mail.

In other cases, the ETOE or consolidator improperly uses Universal Postal Union forms and coding to suggest that the material was mailed through the United States Postal Service. We have also found that some may use our mail containers when presenting this material to a foreign postal administration, again suggesting that the material was mailed in the United States.

Payment for the reciprocal exchange of mail between nations is governed by a system of international tariffs known as "terminal dues." When material is misidentified as United States Mail, it can skew the actual mail volumes involved, reducing payments due to us or increasing our payments to other posts.

A third situation occurs when an ETOE or consolidator deliberately misdirects its products to the wrong country. For example if an entity operating in the United States does not have a shipment of sufficient weight to a destination country, it may deliberately ship its material to another nation for which the weight threshold is satisfied. If that occurs, the receiving country may forward the shipment to the actual destination country at the expense of the United States Postal Service.

Perhaps a more serious consideration is the fact that United States screening and safety standards, designed to enhance homeland security, may not be employed by ETOEs or consolidators. This means that material improperly reentering the United States as mail has not been subject the same rigorous scrutiny as international mailings actually initiated through the United States Postal Service.

We are working to address our concerns through other posts and the Universal Postal Union. These efforts can be enhanced through increased awareness among federal agencies that utilize third-party international mailings as well as the creation and application of stronger standards for operators who maintain a presence in the United States. Your understanding and support of our efforts can be of tremendous assistance and avoid unnecessary costs for American mail users.

Before I close, I want to acknowledge the work of Comptroller General David Walker over the last decade as the Postal Service intensified its efforts to become more effective and more efficient than ever. Mr. Walker understood that the ultimate transformation of the Postal Service was not simply an organizational issue; it was a critical public policy issue. He understood the need for new legislation that would provide the Postal Service with the flexibility necessary for success in a radically changed and dynamic business environment. I offer Mr. Walker my best wishes as he moves on to a challenging new phase of his career.

We are entering a period of profound change. Through the new postal law you have provided us with a new ability to navigate that change. As we begin this journey, I am grateful for your continuing support of a sound and financially independent Postal Service.

I would be pleased to answer any questions you may have.

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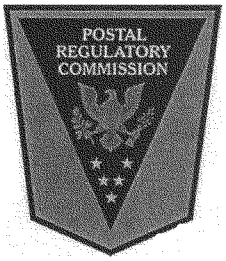

Testimony of

The Honorable Dan G. Blair, Chairman

On Behalf of the

Postal Regulatory Commission

Before the

U.S. Senate

Committee on Homeland Security

and Governmental Affairs

Subcommittee on Federal Financial Management,

Government Information, Federal Services,

and International Security

March 5, 2008

Thank you Chairman Carper, Ranking Member Coburn, and members of the Subcommittee. I appreciate this opportunity to review with you the activities of the Postal Regulatory Commission since the enactment of the Postal Accountability and Enhancement Act (PAEA) on December 20, 2006, and my last appearance before the Subcommittee on August 2, 2007.

It has been an exciting and challenging fourteen months as the Commission transitioned into its role as the strengthened regulator from the former rate maker. Just a year ago, on February 26, 2007, we issued our recommended decision on the last omnibus rate case to be considered under the old Postal Reorganization Act of 1970. Less than a month later, at a joint Commission-Postal Service forum on the PAEA, I asked the attendees if they would like to see new ratemaking systems in place before the June 2008 statutory deadline. Fueled by an enthusiastic response favoring regulations "sooner, rather than later," the Commission beat the deadline by eight months. Our hard work set the stage for the first rate increase under the PAEA and resulted in the Postal Service foregoing one final rate case under the old law.

Completing the ratemaking regulations ahead of schedule is just one of the many tasks we undertook last year. In addition to establishing a new ratemaking process, the Act requires the Postal Service – in consultation with the Commission – to develop modern service standards for all market dominant products by the end of 2007. To guarantee public participation in the process, we solicited written comments from mailers and consumers and held three field hearings outside of Washington, DC, where witnesses shared their expectations for service standards and ratemaking regulations. We are now in the second phase of our consultation – establishing goals for performance measures and network reorganization, which is due to Congress in June.

To further our commitment to a primary cornerstone of the new law – accountability and transparency – we reorganized the Commission. A comprehensive management review aided in the identification of key strategic goals, which allowed us to align our goals and office functions with the Commission's multiple mandates of the PAEA. We also began a complete redesign of our agency's website to ensure greater public accessibility and ease of use that will be completed this spring. A complementary activity is the upgrading of our Information Technology systems. We also appointed an Inspector General, as required by the law, who has provided the first semi-annual report to Congress.

I am also pleased to report that the Commission has formally released its first Strategic and Operational Plan detailing the agency's vision and goals over the next five years. The Plan outlines the strategies and activities that the Commission will use to help ensure transparency and accountability of the Postal Service and to foster a vital and efficient universal mail system. By emphasizing the operational work that must be accomplished over the next five years, the Commission can evaluate its progress and performance on the strategic goals outlined in the Plan.

In addition, the PAEA directs a new funding process for the Commission. Prior to enactment of the new law, the Commission submitted its annual funding requests directly to the Governors of the Postal Service, which in turn, directed the Postal Service to fund the Commission's budget from the Postal Service Fund. The Act sought to ensure the Commission's independence through the appropriations process by having Congress instruct the Postal Service to fund the Commission's budget from the Fund.

I am extremely proud of our accomplishments last year. However, the Commission will be even busier this year. As you know, the Postal Service filed rate increases for market dominant products with us on February 11, 2008. This filing puts into motion the regulations we finalized last October. Interested parties had until March 3, 2008, to submit comments to the Commission regarding the rate increases that will become effective on May 12, 2008. Now that the public comment period has ended, the Commission has 14 days to review the comments, decide if the rate changes meet the requirements of the PAEA, with particular focus on satisfying the CPI-based cap, and issue an order. Although the PAEA ensures a minimum of 45 days advance notice, the Postal Service is providing 90 days notice.

At the same time that the Commission is reviewing the first market dominant rate increase, we are also completing our first Annual Compliance Report. Work is underway to analyze the Postal Service's costs, revenues, and service data from fiscal year 2007. We have held two technical conferences regarding changes proposed by the Postal Service for Periodicals cost models, and we have asked for public comments on all aspects of the Service's Compliance Report filed with us at the end of 2007. This annual review, required by the PAEA, is due by March 27, 2008. Successfully managing these two responsibilities simultaneously, and within a compressed timeframe, demonstrates the Commission's ability to balance its resources and staff effectively. I would like to note that this year's compliance analysis will report on rate increases under the old cost-of-service system, which did not separate postal products. Future reports will analyze data for the two categories of mail established by the PAEA – market dominant and competitive products.

It is our obligation to develop, with input from the Postal Service and the mailing community, rules to ensure that the Postal Service provides sufficient reliable data to enable the Commission to prepare accurate and informative reports and studies as required by the PAEA. Good data is the foundation that supports meaningful transparency and allows for careful and conscientious analysis, and reports that provide real accountability.

We are engaging in other critical activities related to PAEA mandates, including the development of accounting principles and methods to calculate the "assumed" Federal income tax on competitive products. Our final rules will be issued no later than December 20, 2008, and will have the benefit of recommendations made to the Commission by the Department of Treasury at the end of 2007, in addition to public comments, which are being solicited now.

I wish to note that applying an assumed Federal income tax on competitive products is a unique requirement of the PAEA. Approximately 10 percent of the Postal Service's revenues are generated by products, such as Priority Mail and Express Mail, which are offered in competition with private firms. By law, the Postal Service must compute an approximation of the Federal income tax it would pay on its competitive products to ensure fair competition with the private sector. We will have final rules by the end of 2008.

We are currently working on our report to Congress on the universal service obligation (USO) and the postal monopoly, due by December 20, 2008. Commission staff, assisted by a contractor, will review the history of the postal monopoly, including the Mail Box rule, universal service in the United States and other countries, and the varied needs of individuals and businesses. To ensure active public participation, we plan to hold field hearings early this summer as well as solicit public comments. We are also asking the Postal Service, which is conducting its own review of the USO, to provide the Commission with the benefit of its recommendations and observations prior to releasing our final report to Congress. Further, we look forward to consulting with the Postal Service, as required by the PAEA.

We have also initiated discussions with the Postal Service on a joint Commission-Postal Service review of Periodicals costs that is required by the PAEA. Although the Act did not specify a completion date for this report to the President and the Congress, we believe that comments made during a House hearing justify the undertaking of the review now.

Mr. Chairman, I have laid out how the Commission moved quickly over the past 14 months to meet its responsibilities under the new law. We have shaped the new postal regulatory environment, and we are meeting our newly mandated responsibilities well. As part of this new environment, we are mindful that the Commission's strengthened regulatory authority includes our ability to issue subpoenas, order remedial actions, and levy fines in instances of noncompliance with applicable postal laws. We are formulating a new formal complaint system to strengthen the Commission's existing process to ensure even greater transparency and accountability. Work has begun on drafting new regulations, and we are instituting a system to process and track informal consumer concerns. Because so many consumer inquiries to the Commission are outside our scope of responsibilities and relate to postal delivery service issues and operational matters, our Office of Public Affairs and Government Relations works closely with the Postal Service's Office of Consumer Advocate to ensure more timely and responsive actions.

I would like to address one final issue before I conclude my written remarks. I wish to discuss the future of agreements between the Postal Service and individual mailers, commonly referred to as Negotiated Service Agreements (NSAs). Up until very recently, the Postal Service operated as a tariff industry – offering products on the same terms to all its customers. However, in 2002, the Postal Service began negotiating contracts with specific mailers.

The PAEA codifies the use of NSAs as one of the factors of the Act, and contemplates an expedited review process that we interpreted through our ratemaking regulations. The law is very specific, and our regulations directly reference section 3622(c)(10), among other provisions, as the basis for the Commission's review of NSAs. This section requires that market dominant NSAs must either improve the net financial position of the Postal Service or enhance the performance of operational functions. In addition, NSAs may not harm others in the marketplace and must be available to similarly situated mailers. Competitive product NSAs must cover attributable costs.

I wish to assure the Chairman that we will review NSA filings from the Postal Service in this light. Moreover, reviewing the data behind these filings will be a critical component of the Commission's Annual Compliance Report to Congress. I understand many stakeholders may have questions about the Commission's review of NSAs under the new rules and the guidelines and criteria the Postal Service uses in evaluating a potential agreement. To address these questions, the Commission looks forward to working with the Postal Service in an effort to explore ways of resolving stakeholder questions and issues on how to best utilize NSAs.

In closing, I wish to thank the Subcommittee Members for their continued support of the Commission and our activities. I also wish to thank the Members for their work in bringing about postal reform. Moving from the lengthy, highly litigious rate cases in favor of annual rate increases capped at the CPI allows businesses to foresee their mailing costs. The predictability of rate increases and the transparency of the data behind cost adjustments will bring more value to the mail.

Thank you, and I will be more than happy to answer any questions the Subcommittee may have.

Post-Hearing Questions for the Record
Submitted to John E. Potter
From Senator Thomas R. Carper

"The State of the U.S. Postal Service One Year After Reform"

March 5, 2008

1. You note in your testimony that, when postal prices go up, mail volume typically declines in the short run but returns to or even surpasses previous levels in the long run. This apparently did not happen at the end of fiscal year 2007 into fiscal year 2008. Is this due entirely to the economic downturn or were there also some permanent changes to your customer base? How much of your lost volume do you anticipate getting back once the economy picks up? Do you know yet what impact the May price changes will have on volume in the short and long term?

A. Our revenues after the first quarter were down some $525 million. After the first two months of the second quarter, they are down another $400 million. We expect that mail services revenue for the remainder of FY 2008 will be below planned revenue.

This is due to the current and projected effect of the economic slowdown combined with the mailers' adjustments to the 2007 rate increases.

Revenue-per-piece declined as mailers changed to alternative formats that allowed them to mitigate the May and July 2007 rate increases. These efforts have resulted in a reduction in the size and weight of flat rate mail pieces, including catalogs.

Further, the slowdown in the economy and the difficulties in credit markets are expected to directly impact financial services mailings as well as advertising mail originated by other business sectors.

The Postal Service is aggressively reducing expenses to mitigate the financial impact of the economic slowdown. In our recently completed financial review, we identified an additional $1 billion of cost reduction efforts—much of which is tied to reduced volume—that we will undertake to bring our finances back into balance to adjust to the current environment.

That combined with the projected $735 million in increased revenue from the coming price adjustment, should reduce our projected 2008 loss from $2 billion to $265 million.

FY 2008 will be a very challenging year. Any changes in the economy will have greater impact on postal finances now that Standard Mail has become

our volume-leading product. We are now in a slowdown period. While we cannot predict the extent of the economic slowdown, based on the economic forecasts we review and on our own internal forecasts, we have taken aggressive actions to align costs with revised forecasts of reduced volume and revenue.

2. Assuming the economy does not start picking up rather quickly, you will be counting on some dramatic cost cutting this year in order to prevent major losses. I believe you are hoping to take $1 billion out of the system. Where will you find these savings? Should we be worried that success in achieving $1 billion in savings will have a negative impact on service?

A. We plan to aggressively manage expenses while keeping our commitment to outstanding service. In general, our plan is it reduce overtime, move mail from more expensive air to ground transportation, and to realize savings from supply chain management and our capital investments.

We also plan to take full advantage of the pricing flexibility afforded by the new law, work with customers to better meet their needs and, find new ways to grow revenue. We have weathered stormy waters before and I am confident that we will do so this year.

3. I understand that the Postal Service has achieved record performance levels recently. And I hear that there may have been some improvements in service in areas like Chicago that have seen some serious problems recently. What steps have you taken to improve service since the last time we met here? With the new service standards going into effect, what are you doing to measure performance?

A. Improving service in Chicago has been a priority for the entire organization. I am pleased to report that First-Class Mail service has experienced a five-point improvement over the first quarter from last year, and that we have seen solid improvements across the board in two and three-day service. We have a long list of areas that have received our attention in Chicago including:

- **Overhauling our equipment**
- **Revising and standardizing plant processes**
- **Updating databases**
- **Hiring carriers**
- **Increasing employee training**

- **Making executive and managerial changes**

Regarding service standards, the law required that the Postal Service take customer satisfaction, the needs of customers, and the actual level of service that customers receive into account in the establishment of modern service standards. We conducted extensive consumer outreach to determine these standards and determined that customers want standards that are reliable, consistent, realistic, and attainable, and that any proposed changes reflect sensitivity to the impact of increased postal costs on rates that they pay.

The new service standards, seek to meet these goals by aligning standards with today's operational and logistical capabilities, while continuing to differentiate among distinct products and minimize any adverse impact on postal and customer costs.

4. It was always my hope that the new service standards called for in the postal reform bill would help the Postal Service make it and the products it offers more relevant and valuable. What is the current status of the development of the new service standards? How are you using them strategically to better develop key postal products?

A. We consulted with the PRC and mailers to develop a Service Performance Measurement approach. We have already reached agreement on the frequency and scope of reports which will be generated on a quarterly basis for each of our 80 Districts.

Performance reports will be generated for each one of the products under the Market Dominant category. And for certain products, performance reports will be broken down – for example, First-Class Mail will report separate results for Single-Piece and Presort First Class. Within these two categories we will track overnight, two-day, and 3/4 day performance.

The measurement system itself will expand upon the existing External First Class Measurement System (EXFC) administered by IBM. As an initial step we have agreed to expand the EXFC system to cover nearly all 3-digit ZIP codes. This will require IBM to expand its use of "droppers" and "recipients" of test mail pieces. It is anticipated IBM will complete this expansion this summer.

Beyond the EXFC approach, measurement of presorted mail will employ the expanded data available via the implementation of the Intelligent Mail Barcode. This will significantly increase the amount of diagnostic data used to improve service performance.

For those customers who adopt Intelligent Mail Bar codes, diagnostic data will be available for them to analyze their own service performance experience. In addition, they will be able to use this data to increase the value of their own mail by identifying opportunities to improve.

5. Staying on the subject of service standards, the postal reform bill requires you to submit a report this July telling us how you plan to use those standards to reorganize the Postal Service's facilities network and workforce, among other things. Can you take a minute or so to talk a little bit about how you plan to take advantage of this opportunity? Is this effort something that you can use to realize some savings in the coming years?

A. The Postal Service plans to outline its vision for the network in the Facilities Plan due to Congress in June 2008. Our objective is to create a network that produces the lowest combined cost for USPS and our customers, and improves the consistency of service. Facility consolidations will continue to be implemented in an evolutionary manner, and will be focused on reducing excess capacity, and improving efficiency and service.

6. Last year, we spent a lot of time at these postal hearings discussing contracting out, especially the contracting out of letter carrier jobs. It was clear to me at the time that the Postal Service was contracting out more mail delivery than it had in the past and that there were some security and quality of service concerns springing up as a result. There was also some question about whether the contracting out effort was permitted under your unions' contracts. I understand that you have been working with the unions over the past few months to come to some sort of understanding on this issue. What is the status of those efforts?

A. The USPS-NALC committee has met and has begun exchanging information consistent with the terms of the Memorandum of Understanding. Additional meetings are planned, but it is too soon yet to discuss possible findings or recommendations.

7. Over the holidays, I went and volunteered with a group in Delaware that was sending Christmas stockings to soldiers serving overseas. The woman who was heading up that effort talked to my staff and me about how the cost of sending the stockings was somewhat higher this time around under the most recent price increases than it had been in past years. And she pointed out that competitors like UPS and FedEx are not an option because they cannot deliver to APO and FPO boxes. What might be the reason for the increases? Is there anything that you plan on doing to keep the price of these kinds of mailings under control?

A. First, I would like to note that the prices for packages to APO/FPO addresses so far have been priced the same as domestic packages and the

prices have not increased for overseas military mail in any greater way than domestic mail. In addition, in a first for the Postal Service, we have introduced a large flat rate box that is priced $2 less if it is addressed to an APO/FPO address. And, the price of this new box will not increase in May– it went on sale March 3rd and its price will remain steady for the rest of this year.

8. You mentioned at one point in your testimony that the Postal Service is prohibited by law from using post offices to offer services such as banking or really anything not directly related to the mail. I recall having a lengthy debate with my colleagues as we were working on the postal reform bill about the extent to which the Postal Service should be able to offer so-called "non-postal" products and services. We ultimately decided to be relatively restrictive in our bill. What do you think the Postal Service should be able to offer in post offices? Are there any specific changes to current law that you would recommend that we make so that the Postal Service has more commercial freedom?

A. The PAEA eliminated the Postal Service's authority to offer "nonpostal" services pursuant to former 39 U.S.C. § 404(a)(6), except for "nonpostal" services that were offered on January 1, 2006, and are approved by the Postal Regulatory Commission. We interpret this aspect of the reform law as eliminating the Postal Service's ability to directly offer any new service that is not a "postal service" within the law's definition of that term, or that is not authorized by a provision of title 39 of the U.S. Code independent of former section 404(a)(6). "Postal service" is defined in the law as essentially any service that is closely related to, or directly supportive of, the provision of mail service. Examples of independently authorized services include government services offered to the public on behalf of other federal agencies (such as the acceptance of passport applications), which we are authorized to provide pursuant to 39 U.S.C. § 411, and philatelic services, which we are authorized to provide pursuant to 39 U.S.C. § 404(a)(5)

Going forward, we believe that the new law did not affect our legal authority to lease out space to private parties to provide their services to the public. However, the law prevents the Postal Service itself from directly offering any new "nonpostal" services, even if the Commission approves of the service. As I said in my testimony, posts around the world are diversifying in order to meet the challenges we face now and are likely to face in the future, so as to continue to provide universal mail service. I think flexibility should be built into the law so that the Postal Service can, in consultation with the Commission, continue to fund universal service by directly providing services even if they do not fall within the statutory definition of "postal service" (or cannot be justified by an existing provision that authorizes us to provide a discrete service like philatelic services).

Post-Hearing Questions for the Record
Submitted to Dan G. Blair
From Senator Thomas R. Carper

"The State if the U.S. Postal Service One Year after Reform"

March 5, 2008

1. **The Postal Service filed its rate changes for Market Dominant and Competitive products with the Commission on February 11, and March 12, 2008, respectively. As you know, it was the intention of those of us involved in postal reform that the process between Postal Service notice and price implementation be as short and uncomplicated as possible. I hope that you share those same goals. What do you see as the Commission's role in reviewing the Postal Service's proposals between now and May 12? What will you and your colleagues be looking at?**

   Pursuant to the Commission's new regulatory framework, we plan to conduct a focused review. Adjustments for market dominant products will be reviewed to determine whether the proposed adjustments for each class of mail are within the statutory price cap and whether there are workshare discounts that did not conform with the law. This review is consistent with Congressional intent as expressed in the Postal Accountability and Enhancement Act. The Commission's new regulatory framework ensures the transparency and accountability envisioned by the PAEA through a 34-day review process for rate adjustment filings for market dominant products and a less than 30-day review for competitive product rate adjustments.

   The Committee will be pleased to know that on March 17, 2008, the Commission issued its first determination of price adjustments for market dominant products. In that determination the Commission ruled that price adjustments for market dominant products were on average within the inflation-based price cap for each class of mail.

   Rate increases for competitive products have also been filed with the Commission. Regulations for competitive products provide the public with 15 days to comment on whether the new rates are consistent with statutory requirements. Specifically, the requirements prohibit any cross-subsidy of competitive products by market dominant products; that each competitive product covers its attributable costs; and that competitive products, as a group, pay their share of institutional costs, which the Commission set at 5.5 percent.

2. **One of the major complaints about the old ratemaking system was access to the information and transparency. There was a sense – and I don't know if it's accurate or not – that the Postal Service was not always open about what it was doing or about the assumptions and economic data behind what they**

were doing. Have you seen any improvements in this area since the enactment of postal reform and you assuming your current position? How do you plan on working with the Postal Service to improve the transparency of the pricing process and other activities that will be occurring before the Commission?

Access to data and the quality of that information is paramount under this new system as well. During this rate adjustment period, as well as our review of the Service's compliance data, we have conducted two technical conferences to address issues regarding the data, as well as issuing notices requesting clarification in the data submitted by the Service. As I said in my statement, we believe that this less litigious environment is better conducive to a free flow of information between the Service and the Commission, and we look forward to this more open environment continuing.

One of our primary responsibilities is the requirement for an Annual Compliance Determination to the President and the Congress in which we analyze the Postal Service's costs, revenues, and service data from the past fiscal year and certify the Service's compliance with the PAEA. This year's report, released on March 27, 2008, reports on rate increases under the old cost-of-service system that did not separate postal products. Future reports will analyze data for the two categories of mail established by the PAEA – market dominant and competitive products.

Another PAEA requirement is the development of regulations for the accounting principles for the Postal Service and methods of calculating the assumed federal income tax on competitive products income. These should provide an additional source of relevant information and increased transparency.

3. **As you note in your testimony, the Postal Regulatory Commission has taken a lot of steps to reorganize and increase staffing to meet the demands of the postal reform bill. One of the changes you've made is to eliminate the Office of the Consumer Advocate. What steps have you taken to ensure that consumer-related concerns are represented at Commission proceedings?**

The new law provides a far higher degree of protection and transparency for consumers. Because the PAEA significantly changes the way rates would be decided, we know the Commission will have many more focused dockets and fewer major litigated cases. In our reorganization, we are mindful that the new law requires the appointment of an officer of the Commission to represent the interests of the general public. Our new organization allows us to utilize our resources more effectively by appointing individuals with different, applicable skill sets to represent the public in different cases.

As I noted in my written testimony, to augment our existing complaint system, we will have a strengthened formal complaint system to ensure even greater transparency and accountability. Work has also begun on a system to track

informal consumer concerns. To ensure proper handling of the many service delivery and operational inquiries coming into the Commission, which are outside our of regulatory authority, our Office of Public Affairs and Government Relations works closely with the Postal Service's Office of Consumer Advocate to provide more timely and responsive actions.

4. **It was always my hope that the new service standards called for in the postal reform bill would help the Postal Service make it and the products it offers more relevant and valuable. What role is the Postal Regulatory Commission playing in the development and enforcement of the service standards?**

   The Commission has entered into a productive dialogue through the service standard consultation process. My testimony reflected the degree to which we think this process is important. Since last spring, the Commission has been meeting with the Postal Service once a month to discuss service standards and other issues. We are currently discussing service performance goals and measurements and moved to this stage following the conclusion of the establishment of the standards last December.

   This consultation has yielded results. For instance, the Commission questioned why the Service would downgrade First-Class standards for all zip codes to non-contiguous areas like Alaska and Hawaii even if mail were coming from the West Coast.

   The Commission is now reviewing the Service's service measurement proposal, which depends heavily on Intelligent Mail Barcode (IMB) adoption by mailers. To ensure public participation, we established a docket to receive comments on the hybrid proposal, which was due in mid-January. Comments were received up until March 1.

   The Service has told us that it will issue an addendum shortly after reviewing the comments. In the meantime, the Service is moving forward to implement IMB-based systems, and it intends to start measuring its performance in October 2008.

5. **Staying on the subject of service standards, the postal reform bill requires you to submit a report this July telling us how you plan to use those standards to reorganize the Postal Service's facilities network and workforce, among other things. The Postal Regulatory Commission has a role to play in the development of the planning in this area. What would you like to see included in the Postal Service's report?**

   As with service standards measurements and goals, the Postal Service is consulting with us on network realignment, as required by the PAEA. The Postal Service has just initiated these discussions, and the Commission has been briefed by the Government Accountability Office on their work in this area.

In addition, the Commission testified before the House Postal Subcommittee last summer on our opinion related to the Postal Service's 2006 planned nationwide realignment effort, then known as the Evolutionary Network Development (END). When the proceeding started, very little was publicly known about the overall END process, and the Service's vision of its future network was unclear. By the end of the proceeding, the Commission had brought transparency to the Postal Service's proposed network development plans.

In moving forward with this consultation, it will be our intent that any realignment process must be accountable and transparent to postal customers and be sensitive to the needs of the communities it serves. Further, we will assess any realignment efforts with potential impacts on service. We have urged the Postal Service to develop a strong relationship with Congress to ensure that Members of Congress, especially those whose State or congressional district would be impacted, are provided with needed information as to the reasons behind any proposals brought forth.

The Commission believes that proposals to realign facilities should explain how performance will be enhanced [or impacted] and what opportunities to optimize resources are presented by such proposals.

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