S. Hrg. 113–405

POSTAL REFORM—2013

HEARING

BEFORE THE

COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS UNITED STATES SENATE

ONE HUNDRED THIRTEENTH CONGRESS

FIRST SESSION

SEPTEMBER 19, 2013
OUTSIDE THE BOX: REFORMING AND RENEWING THE POSTAL SERVICE PART I—MAINTAINING SERVICES, REDUCING COSTS, AND INCREASING REVENUE THROUGH INNOVATION AND MODERNIZATION

SEPTEMBER 26, 2013
OUTSIDE THE BOX: REFORMING AND RENEWING THE POSTAL SERVICE PART II—PROMOTING A 21ST CENTURY WORKFORCE

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THURSDAY, SEPTEMBER 19, 2013

U.S. SENATE,
COMMITTEE ON HOMELAND SECURITY
AND GOVERNMENTAL AFFAIRS,
Washington, DC.

The Committee met, pursuant to notice, at 10:01 a.m., in room SD–342, Dirksen Senate Office Building, Hon. Thomas R. Carper, Chairman of the Committee, presiding.

Present: Senators Carper, Pryor, McCaskill, Tester, Heitkamp, Coburn, McCain, and Johnson.

OPENING STATEMENT OF CHAIRMAN CARPER

Chairman CARPER. The Committee will come to order. Actually, there is a lot of order here already and, I hope, some optimism. It is a beautiful day out there and I hope that the future turns out to be just as bright as this day has been so far.

Thank you for joining us, Dr. Coburn and I, and some of our colleagues will be coming along shortly. I want to thank our staffs for the work you have done in helping us prepare for this hearing, and for all of you for the work that you have done in preparing for this day.

We meet today to examine the financial challenges facing the United States Postal Service (USPS) and to consider proposals that have been put forward to address those challenges. Since I first joined this Committee, actually 12 years ago as a freshman Senator, one of my top goals has been to not just help the Postal Service get by, but to help it be strong once again and remain viable for the long-term. I think that is a goal we share.

Back in 2006, I worked with Senator Collins, Senator Lieberman, our House colleagues and the Bush Administration, a lot of key stakeholders, to give the Postal Service some of the tools that it would need to deal with the challenges posed by the increasing use of electronic forms of communication.

We had no idea at the time that the worst recession since the Great Depression lay just around the corner, and that it, along with the growing use of email, electronic bill pay, and other communication innovations would so dramatically erode mail volume.

Today, as I have mentioned before at this Committee's hearings and in other venues, we find ourselves closer than we have ever been to losing the vital services that the Postal Service offers, along with the eight million or so jobs that depend on its continued vitality. As we sit here today in the fall of 2013, the Postal Service has maxed out its credit line with the U.S. Treasury and is rapidly running out of cash.

Despite an improving economy and some positive signals, particularly from package delivery and advertising mail, the immediate future for the Postal Service is not bright. Absent legislative intervention, the Postal Service will likely limp along for a few months unable to invest for the future, and with its employees and customers uncertain of what the future holds. It can only limp along this way for so long.

This situation is unacceptable. It is also avoidable and it calls for urgent action from Congress and the Administration. Unfortunately, despite repeated requests from Postal management for assistance, we failed to act. After months of effort, though, to find common ground, Dr. Coburn and I finally succeeded in introducing bipartisan, comprehensive legislation on August 1 that has the potential, to set the Postal Service on the path toward self-sufficiency and relevance in the 21st Century.

And I want to just say here publicly how grateful I am to him and to the folks on his staff for working with John Kilvington and others on our staff and those that are represented in this room and outside this room. A lot of work, hard work, a lot of give and take. But I think in the end it is going to be worth all that effort.

Our bill attempts to permanently address the Postal Service's longstanding health and pension issues and right-size its processing and delivery network while providing it with the tools to generate new revenue in a digital world. Some of you have heard me say this before. I will just say it again.

The Postal Service is unique in this country. Nobody else goes to every mailbox, virtually every door, business and residential, in this country 5 or 6 days a week. There is a great potential to earn additional revenues from this network. We have to figure out collectively how to access that and how to realize that potential.

But my goal with this bill, and I believe Dr. Coburn's goal as well, is to enact a set of reforms that are fair to really three groups of people. One, our Postal customers; two, our Postal employees and retirees; and to taxpayers. Our further goal is to fix this problem, at least for the foreseeable future, and not to kick the can down the road.

Our hearing today will focus largely on the provisions in our bill that relate to Postal rates, potential changes in the levels of service provided by the Postal Service, and the innovations that Postal management must put in place in order for the Postal Service to survive and thrive in the coming years.

It is important to note at this point that despite the relatively positive financial news we have seen in recent months, some tough decisions are still needed in order to get the Postal Service out of the troubles that it faces, and whether it happens today, next month, or next year, it is likely that Postal customers will need to sacrifice at least some of the conveniences that they enjoy today.

Our bill would give the Postal Service the authority it needs to adjust its operations to reflect the changing demand for the products and services it offers, and the changing needs of its customers. The Postal Service today needs to be granted the authority from Congress to make decisions similar to those that our auto companies made in recent years in right-sizing their industry, and enable them to succeed despite the challenges that they face in the 21st Century marketplace in this country.

But the solution to this problem we have gathered here to discuss today cannot be just about cutting. We are not going to cut our way out of this dilemma. It has to be about innovation and it has to be about finding a way for the Postal Service to be almost as important to my son's generation as it was to my generation, while we served our country during the Vietnam War, and to my parents' generation during World War II.

The Postal Service has been attempting to do just that. It has aggressively marketed its package offerings and made them more user-friendly and valuable to customers. It has also partnered with companies like the Federal Express (FedEx), like the United Parcel Service (UPS), like Amazon.com to deliver items the last mile, the last 5 miles, or the last 10 miles to their customers.

For example, in my State, Amazon.com sends trucks out every night, actually in the wee hours of the morning, from their plant in Middletown about 20 miles from where I live. And they send them to Postal Service facilities all over the mid-Atlantic and northeast to deliver overnight items that people have ordered the previous day. Nice piece of business actually.

The bill that Dr. Coburn and I have put forward would help Postal management with its efforts, but also expand the range of products and services the Postal Service can offer by eliminating what was, in retrospect, a short-sighted restriction placed on Postal innovation in 2006. Our provision, along with others such as our language allowing the Postal Service to compete with UPS and FedEx in the shipping of beer, wine, and spirits, is intended to give Postal management the tools they need to make greater use of its one-of-a-kind processing, distribution, and retail network.

At the end of the day, what Congress must do is to provide some certainty to both Postal employees and customers and to ensure that taxpayers, along with all the fiscal challenges we face as a country, are not also saddled with shoring up a failing Postal Service.

I do not want to be back here in a few years discussing how we can dig ourselves out of yet another Postal crisis. I suspect I speak for everyone in this room. I do not believe that any of us want to do that, and as it turns out, if we are smart enough and if we are creative enough and bold enough we will not have to.

In turning this over to Dr. Coburn for whatever comments he wants to make—let me add just a P.S. We face huge fiscal challenges in this country. It is better. We had a big deficit of $1.4 trillion about 4 years ago, huge deficit, and it is now only about $700 billion. It is still a lot. And Dr. Coburn has worked a whole lot on these issues, I have, too, and so have others of our colleagues.

I think there are three ways to actually put our country on the right track financially. One of those is we need to overhaul our entitlement programs in a way that saves money, saves these programs, and does not hurt the least of these in our society. The second thing we need to do is we need to raise some revenues, hopefully by doing more on the tax exclusion side, eliminating a lot of tax breaks, some of the ones that are least productive, rather than just raising rates.

And the third thing we need to do, and this really is what we are talking about here, we need to, in almost everything we do, ask this question: how do we get a better result for less money? The Postal Service cannot continue to be a burden on the Treasury and the taxpayers. We know you do not want to.

I was in a meeting yesterday, Tom, and one of the discussions was, how can we most help get the economy moving even stronger. And some people had different ideas. I think, for my money, for our money, the best way to do it is to demonstrate, in large part, to the business community who are not hiring people, who are sitting on a lot of cash, that we can govern, that we can be fiscally responsible, we can provide certainty with respect to the Tax Code. There are seven or eight million jobs that flow from the Postal Service, and a lot of Postal customers need some certainty that the Postal Service is going to be in business, is going to be able to provide the service that they need and meet their needs.

So there is a lot riding on this and a lot of it involves jobs. Not just the people who work for the Postal Service—we value their efforts—but the people who need the Postal Service in order to survive and thrive. Dr. Coburn.

OPENING STATEMENT OF SENATOR COBURN

Senator COBURN. Well, let me say to you, Senator Carper, we worked hard to try to get a draft bill out. I am committed with you to try to move this process forward. I would thank your staff as well. I think we have a great working relationship. I would thank the input that we got from all the outside groups as we attempted to do this, and my assessment is that since nobody likes it, we are probably right where we need to be. Since everybody hates it, that is usually a good middle ground.

It is a draft. It is a starting point. The reason we are having these hearings today is to hear, in formal ways rather than in the office, what is positive, what is negative, what are the critiques, what are the negatives from everybody's viewpoint.

The fact is, when we finish the Postal bill in Congress, everybody is going to have to give something. We are not going to solve this problem. I would note that we had Professor Geddes from Cornell. Seventy-five percent of the rest of the world has privatized their Postal Service. And his other recommendation is, you cannot have a shrink to grow model.

What you have to do is have products and you have to have pricing capability and that pricing has to be based on what your net revenue can come by hitting the sweet spot for your customer and for the Postal Service. This is a draft because we intend to make further changes based on input. The reason we dropped the bill before the August recess was to make sure that both the customers, the Postal Service, and the workers that work in the Postal Service know that we are committed to getting a deal done.

And we have demonstrated in our compromises that we are willing to do that and we are willing to listen. I am going to work with three priorities in mind. First, the Postal Service should look to cutting costs. They have to. And I would congratulate the Postmaster General on what he has done thus far, but he has a way to go.

The second, we should look for more revenues, not just through price increases, but ingenuity, new ideas, new markets, in ways that do not unfairly allow the Postal Service to compete against the private sector.

Third and last, we should look to the taxpayers as the last resort. As Senator Carper can tell you, I actually believe we ought to let the Board of Governors (BOG) have a lot of power in running this business so they can react to markets, so they can make the kind of changes they need to be competitive.

I will note that yesterday, FedEx raised its prices—its stock went up $5—on the basis that they saw an economy that was brightening in terms of their package service. That bodes well for the Postmaster and all the employees that work for the Postal Service. It also creates some slack and gives them some working room. Those are positive developments.

What the Postal Service and the Postal employees have done with packages needs to be applauded, and we need to ensure that they have the capability through their management structure to be nimble and quick and reflective so they can compete in that market.

The question before the panel today is quite simply, how did we do with the draft? And we have heard the blowback. We recognize that we want to take that in and then we want to work some more. So there is no bill until there is a bill signed by the President, but it is going to have to be balanced and everybody is going to have to make a sacrifice if we are going to solve this problem.

The Postal Service deserves a great deal of credit for staving off the liquidity problems, but that is going to end within a year. And so, we have a short period of time to try to create an organization that can compete, is long-lasting, and represents the service that Americans deserve, and recognizes the dedication of the employees that work for the Postal Service.

The Chairman and I are committed to getting this done. That is why we are here today. And Tom, again, I thank you and I thank all of those that are going to testify for their input.

Chairman CARPER. You bet. We have been joined by a couple of our colleagues. I want to thank Senator Johnson, who is faithful. I do not know if he is as faithful in going to church, but he is faithful in coming to these hearings and I am grateful for that. And I also want to welcome Senator Tester. We have been spending a fair amount of time talking about issues of particular concern to Montana, and I value that contribution and look forward to both of your strong participation as we go forward.

I want to just briefly welcome our witnesses. No strangers to this panel. They will be glad when they do become strangers to this Committee. Our first witness is Patrick Donahoe. People say, How does he pronounce his last name? I say, It is like who, as in who, as in who are you. So just keep that in mind as you say his name. He does not care, though.

Mr. Donahoe is the Postmaster General and Chief Executive Officer (CEO) of the Postal Service. Mr. Donahoe has spent his entire career at the Postal Service, beginning as a clerk in his hometown of Pittsburgh, and spending many years in top leadership positions before being appointed Postmaster General in 2010.

Our next witness is Ruth Goldway, Chairperson—do you like to be called Chairwoman? I would if I were a woman. How do you like to be referred to?

Ms. GOLDWAY. Thank you, Senator. We had a long discussion about this at the Commission and determined that it should remain Chairman.

Chairman CARPER. All right.

Ms. GOLDWAY. That is the term of art for the position, as opposed to the sex.

Chairman CARPER. We will go with that. Chairman of the U.S. Postal Regulatory Commission (PRC) it is. Ms. Goldway has served on the Commission for 15 years, dating back to her appointment to that body by former President Clinton in 1998. She has led the Commission as its Chairman since 2009.

The final witness for the panel, David C. Williams, is Inspector General (IG) for the Postal Service. In addition to his current position, to which he was appointed in 2003, Mr. Williams has served as Inspector General to no less than four other Federal agencies, including the Nuclear Regulatory Commission (NRC) and the Department of the Treasury.

We thank all of our witnesses for being here. We would ask that you keep your testimony to about 7 minutes. If you go way beyond that, I will rein you in. But I know some of you have a lot to say and we want to make sure you have a chance to say it.

With that, I will say, Senator Heitkamp, welcome. Great to see you. We are looking forward to welcoming you to Delaware tomorrow, too. All right?

Senator HEITKAMP. I look forward to it as well, Mr. Chairman.

Chairman CARPER. Thank you. There you go. Mr. Donahoe, you are our lead-off hitter. Please proceed. Your entire statements will be made part of the record.

TESTIMONY OF THE HON. PATRICK R. DONAHOE,[1] POSTMASTER GENERAL AND CHIEF EXECUTIVE OFFICER, U.S. POSTAL SERVICE

Mr. DONAHOE. All right. Thank you, Mr. Chairman. Good morning, Mr. Chairman, Dr. Coburn, Members of the Committee. Thank you, Mr. Chairman, for calling this hearing.

The Postal Service is a tremendous organization. It has a proud, dedicated workforce that delivers mail and packages to every business and residence in America. It does so affordably, securely, and reliably. The Postal Service plays an incredibly important role in the American economy and in American communities. And yet, it is in the midst of a financial disaster.

[1] The prepared statement of Mr. Donahoe appears in the Appendix on page 55.

Over the past 2 years, the Postal Service has recorded roughly $20 billion in net losses and defaulted on $11.1 billion in retiree health benefit payments to the U.S. Treasury. We will default on another $5.6 billion payment due September 30 of this year, and our cash liquidity remains dangerously low.

The Postal Service, as it exists today, is financially unsustainable. It is burdened by an outdated and inflexible business model. Without significant structural changes, it will continue to record large financial losses. We must get on the path to financial stability quickly and we need your help to do so.

Earlier this year, the Postal Service published a comprehensive business plan designed to restructure the organization and to return it to profitability. If fully implemented, our plan will generate $20 billion in savings by 2017, including repayment of our debt. The Postal Service is pursuing elements of this plan very aggressively and we are achieving some great results, especially in the area relating to consolidation of mail processing facilities, elimination of delivery routes, optimizing our retail network, and generating new revenue in our package business.

Unfortunately, the strategies that we are allowed to pursue cannot get us to the $20 billion mark by 2017. To fully implement our plan, we require the enactment of legislation that reforms our business model. I want to make the point that the legislation we are seeking is not merely about closing the large budget gap. We want to be an organization that can readily adapt to the changing demands of our customers. The marketplace for mailing and shipping services is changing and the Postal Service requires the legal framework that enables us to act with speed and flexibility.

While we always meet the universal service obligations and meet the basic products and service expectations of the American public, this legislation could determine whether we can continue to do that in the future. Can we be much more nimble and efficient and continue to invest in the future of the mailing industry? Yes, but we need the flexibility to do so under this law.

In 2006, the Postal Service was given additional flexibility by Congress to better compete in the package delivery business. We made the most of that flexibility. We have created effective products and marketing campaigns and now our package business is growing very rapidly. We need this kind of flexibility across all of our businesses.

We believe there are tremendous opportunities to leverage that and technology to make mail more compelling as an investment for American businesses. We also believe that there are great opportunities for the Postal Service to provide digital offerings in the future.

If we are able to operate with greater product and pricing flexibility under the law, and if we can do so from a strong financial position, I am confident that we can develop and market products and services that drive growth in the American economy and benefit America's mailing industry.

Mr. Chairman, we are highly focused on the health of America's mailing industry. Mail is a communications channel that competes against digital, print, broadcast, and other media channels. Industry-wide innovation is very important and the Postal Service should have the flexibility to support and speed that innovation. We also need to keep mail affordable so that it remains competitive and continues to deliver value for American businesses.

Unfortunately, because our financial condition is so precarious and the legislative process is so uncertain, we have reached the point that we have to consider raising prices above the rate of inflation. I believe it is important that we discuss this issue today because the prospects for legislation have a direct bearing on pricing decisions that may impact the health of our business customers.

Let me conclude with the following thought. The Postal Service is quickly moving down a path that leads it to becoming a massive, long-term burden to the American taxpayer. The legislation that you are considering is a great starting point to get us off the path to disaster and onto the path of continued financial stability.

We agree with the overall approach taken by Senate Bill 1486. It provides important pricing and product flexibility and a strong framework for restructuring the Postal Service. However, in order to meet the goal of generating a savings of $20 billion by 2017, the legislation must resolve our long-term health care costs. I believe this is achievable and I am greatly encouraged by recent discussions that we have had on this topic, which I know we will continue to discuss next week.

I would like to thank the Committee for taking up postal reform legislation this year and I look forward to supporting your work and hope to help in any way I can. This concludes my remarks. Thank you very much.

Chairman CARPER. Postmaster General, thank you very much. Chairman Goldway, please proceed.

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

Ms. GOLDWAY. Thank you, Chairman Carper, Ranking Member Coburn, and Senators Johnson, Heitkamp, and Tester. Thank you for the opportunity to testify today. I am pleased to represent the Postal Regulatory Commission and to share its views on the important topic of Postal reform.

We appreciate your leadership in shaping the debate on what must be done to assist the Postal Service and to assure its sustainable future. The Committee has convened this hearing to explore how the Postal Service can be renewed and reformed, to thrive in this changing environment, and to examine the solutions set forth in Senate Bill 1486.

Certainly, there is broad agreement that legislative changes are needed to place the Postal Service on a more sound financial footing. Nevertheless, the Postal Accountability and Enhancement Act (PAEA), contained numerous reforms that were a positive force for change toward modernizing the Postal Service. Efforts to renew and reform the Postal Service need not and should not replace the many positive provisions included in the PAEA.

My written testimony emphasizes the importance of transparency and accountability in the efficient provision of Postal services, and addresses the Commission's experiences and views on a

[1] The prepared statement of Ms. Goldway appears in the Appendix on page 71.

variety of issues addressed in S. 1486. For example, the PAEA significantly increased the transparency and accountability of the Postal Service by mandating accurate and periodic financial reporting that is subject to Commission review and public comment.

However, in my oral statement, I will focus on ratemaking, an area where the Commission has broad responsibilities. A major focus of the PAEA was ratemaking. It sought to end the Postal Service's reliance on unpredictable price increases and concerns that the Postal Service was passing along the costs of less than optimally efficient operations to mailers through cost of service ratemaking.

The PAEA achieved these goals by introducing a regulatory price cap regime for those Postal Service products, over which it enjoys a statutory monopoly or possesses market power. The Postal Service's rate adjustments for these market-dominant products are now at predictable intervals and rate increases for each class of mail are capped at the rate of inflation.

This rate cap approach has had many positive impacts in many areas. Most importantly, it has protected rate payers from large, unpredictable rate increases that were permissible under the old law. The ability to accurately budget for rate increases has reduced disruption to mailer operations and permitted mailers to plan their mailing programs with regular reliability.

The price cap has also successfully motivated the Postal Service to implement extensive cost-saving strategies to achieve increases in efficiency. Since the price cap became effective, the Commission has reviewed the impact on service of many proposed changes intended to reduce the costs of mailing, processing, transportation, and delivery.

Now, degrading the reliability of service is not an acceptable way to reduce costs. The PAEA requires the Postal Service to enhance service measurement, and the Commission to review service performance reports as part of its annual compliance determination. The PAEA does, however, provide an exception to the price cap, an emergency rate provision.

It requires that the Postal Service justify this price increase based on extraordinary or exceptional circumstances to an independent, impartial regulatory body. This has guarded customers from unwarranted exigent price increases. This protection is particularly important in a government-mandated monopoly environment.

The PAEA sought to eliminate the lengthy and expensive rate case litigation that had occurred under prior law. It implemented this goal by providing the Postal Service with increased flexibility to set prices within the bounds of the inflation-based price cap regime, and requiring the Commission to design and implement a modern system of rate regulation.

The Commission developed a simplified process that replaced the 10-month adversarial proceeding required under prior law. The new expedited process has significantly decreased litigation-related expenses for both the Postal Service and the mailers and organizations that formerly participated in rate cases.

Since the passage of the PAEA, the Commission has reviewed rate adjustment proposals to assure compliance with the law promptly and efficiently. Excluding the one exigent rate case, rate requests have been completed on an average of just 37 days. The Commission completed its one exigent rate request in 86 days. And I think it is noteworthy that no mailer has filed a complaint related to a rate adjustment that was reviewed and approved by the Commission.

The Commission stands ready and willing to continue to assist the Committee, Congress, the Postal Service, and stakeholders to ensure the Postal Service can meet its challenges now and well into the future. When Postal reform is enacted, the Commission will swiftly and responsibly implement the new law to ensure that the Postal Service remains an effective part of the overall American communications network.

Thank you again for providing me the opportunity to testify today, and I would be pleased to respond to any questions the Committee Members may have.

Chairman CARPER. Good. Madam Chairman, thank you so much for your testimony and for your willingness to respond to those questions. We are going to have a number of them, I promise. David Curtis Williams, welcome back. Good to see you. Thanks for your testimony. Thanks for the good work that you do. Please proceed.

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

Mr. WILLIAMS. Thank you, Mr. Chairman, and Senator Coburn and the Members of the Committee. I appreciate the opportunity to testify today. Since 2007, the Postal Service was hit with rapid volume losses due to the economic downturn and Internet diversion. The decline in mail volume now appears to be slowing. The financial crisis, though serious, is leveling off.

The Postal Service has taken dramatic and successful actions to optimize its network to the reduced demand. The focus today, however, is on the revenue side, and my office has conducted two related studies. The first study found the Postal Service's ability to generate needed revenue under the Consumer Price Index (CPI) price cap is largely dependent on unlikely increases in volume. This is true of any labor intensive enterprise subject to price controls.

The Postal Service's obligation to deliver daily to a growing number of addresses alone assures that it will remain labor intensive. Mail volume was expanding significantly when the CPI cap was deployed. Also, at that time the monopoly, even with the universal service requirement, was a lucrative asset. These conditions suggested the need for a price control since monopolies can be impervious to efficient market forces.

In 2007, mail growth abruptly reversed. With fewer pieces of mail going to a delivery point, each remaining piece of mail had to raise more revenue to pay for the cost of delivery. Sufficient revenue above inflation was unavailable under the price cap. Recent volume losses, combined with the price cap, imperil the Postal Service's ability to provide universal service while remaining self-funded.

[1] The prepared statement of Mr. Williams appears in the Appendix on page 87.

The price cap was intended to protect trapped monopoly customers, but the monopoly has lost much of its value since there is powerful competition for each type of mail today, advertising, personal communications, business transactions, and parcels. Customers have alternatives and the diminishing monopoly, combined with the universal service requirement, is now a growing liability. Our study suggests adjusting the CPI cap to take into consideration volume fluctuations and revenue generated per delivery point.

The second study examined how sensitive postal customers are to price increases above CPI. We found that for moderate, predictable price increases, postal products generally have low price elasticity. That means small increases would provide badly needed revenue. As prices are increased, some volume will leave, but the associated revenue loss will be more than offset by revenue from the price increase.

The study examined 20 years of data through 2012 and looked for any changes in price sensitivity, including from the Internet and from the recession. We are not saying that all postal customers have a high tolerance for price increases. Some customers remain price sensitive. Rather, as a whole, the demand for these postal products has low price elasticity. Current fears of a postal collapse are likely a far greater risk than a small price increase.

Pricing freedom through efficient market forces should be used when possible. Casting them aside in favor of artificial controls has been problematic and it is problematic for the Postal Service today. Efficient market forces have a long history of successfully disciplining companies. If the Postal Service loses customers with excessive prices, it will suffer the same punishing consequences as any other business.

New innovative technologies offer many opportunities to improve core postal operations and customer service. Vast data generated throughout the network can be mined for operational efficiencies. Global Positioning System (GPS) can optimize routes, manage the fleet, and track packages. Mobile imaging can provide customers visual delivery confirmation. Sensors and their Radio-frequency identification (RFID) technology can digitally link postal equipment and vehicles, providing real-time visibility in all aspects of the network, joining the Postal Service to the Internet of things.

In this remarkable but highly imperfect digital age, citizens and businesses face fundamental problems. The loss of privacy, security, and confidentiality; the fragmentation of messaging—Toyota could not connect the dots between written correspondence and email complaints several years ago—the difficulty of navigating e-government services, the risk of buying online from unknown individuals, uneven broadband and banking access, and expensive e-commerce middlemen that inhibit entrepreneurs and small businesses.

The Postal Service can help address these problems. Secure electronic messaging can preserve privacy, security, and confidentiality. Storage and integration services can give people tools to organize communications in a multi-channel world. The Postal Service can offer seamless e-government services by supporting the digital platform with its network of post offices and delivery carriers.

The creation, storage, and validation of digital identities would protect against the risks of transacting with unknown people and businesses. Post offices can become centers of continuous democracy, acting as hubs to gather citizen input. The sale of single-use cash cards and the cash redemption of digital currency can provide alternatives for the unbanked, enabling their participation in commerce.

And virtual post office boxes can offer citizens and foreign buyers of U.S. goods delivery of their packages anywhere and anytime, and support businesses with back-end operations such as micro-warehousing. The Postal Service already has a physical network underlying the emergent wired digital infrastructure. By further enabling that network, the Postal Service can assure that e-commerce is seamlessly supported by powerful fulfillment services for physical goods.

The Committee's attention to revenue and innovation is tremendously important and pre-funding, which the Committee will take up next week, is also a substantial factor in the plight of the Postal Service's finances. Part of the need for the price increase and absence of investment capital for innovation are directly tied to the financial drains from pre-funding. Thank you.

Chairman CARPER. Well, thank you. Boy, you had a mouthful there, did you not? That was good stuff. I am going to ask the Postmaster General just to react to some of what Mr. Williams has just shared with us in terms of additional things that we can do to help the Postal Service to reduce its costs. He gave us a whole laundry list of things that the Postal Service can do to help us on the revenue side. So just be thinking about reacting to those ideas.

My colleagues have heard me talk about this before. When I think about the problems that the Postal Service faces and has faced for a number of years, I go back to another legacy industry and that is the auto industry. It was not that many years ago where we were in the tank and we had seen our market share drop from about 85 percent, 30 or 40 years ago, to about 45 percent.

And the question was what are we going to do about it? Are we going to give up, just let everybody else in the world take the business away from us and send the auto industry down the tubes or not? And they chose not.

A couple of things happened there and I think they are relevant for us today. One, they right-sized their enterprise. They said, we have more manufacturing plants than we need given our market share. They had more parts plants than they need, they have more employees than they need.

And what they did, they did not just fire people. They did not abrogate labor contracts, but they decided to right-size the enterprise, in a humane way. And they also decided, how can we use what we have in order to generate additional revenues? And they are generating a whole lot of revenues. They are generating the kind of products that people want and are willing to pay for. So I think there are some lessons to be learned there in terms of right-sizing the enterprise, and we have those opportunities, and what we are trying to do is just that.

Remember when people used to kind of joke and say that the big three—Ford, Chrysler, General Motors (GM)—were really a provider of health care to several hundreds of thousands of people and they had a subsidiary that made cars, trucks and vans? Well, when you look at the Postal Service, it is not that bad in terms of being a provider of health care that has a subsidiary that delivers packages and mail.

But the health care costs are substantial. And in the auto industry what they have done, United Automobile Workers (UAW) steps up and says, We would like to take over running the health care for our members and for our retirees, and we want to do it—we think we can do it in a more cost-effective way. They call it the Voluntary Employees Beneficiary Association (VEBA). They have done it and it has actually worked.

I know there are discussions going on with the Postal Service and with your unions and other employee groups, and I just encourage you to continue to do that because that is huge. As we try to find ways to bring down costs, that is just critically important.

I like to say that in adversity lies opportunity. This challenge from the Internet, from folks that are taking away your first-class business, that challenge is going to be there for a long time. But with that challenge comes real opportunity. When I checked our mail last week, we get all kinds of stuff. I know my colleagues do, we all do, all kinds of stuff in the mail.

Last week I got a little envelope from you, from the Postal Service, and it is a mailer here that talks about priority mail express and how the Postal Service will deliver 1-day, 2-day, 3-day service. You can deliver it on Sunday, guaranteed delivery, insurance paid for up to a certain level. Really good stuff.

This is the kind of thing that has a huge, huge upside potential, I think. And in an age when a lot of people still want to deliver stuff on Saturdays or Sundays this kind of thing could help us. I just applaud you for this kind of innovation.

I want you to go take a couple minutes and respond to some of what David Williams has been giving us, particularly his laundry list, not just on the cost side, but his laundry list on the revenue side. Go ahead, please.

Mr. DONAHOE. Thank you, Mr. Chairman. I appreciate the fact that, on the mailing we sent you, 11 scans is our average, so we provide a lot of visibility on those packages, too. Priority Mail is a heck of a deal.

Let me respond to Dave Williams. Dave and the IG have been excellent partners with us on a number of subjects over the past few years. We have asked them to take a look at opportunities, and he and his team have come back with a lot of good suggestions.

I think the key thing for us to keep in mind looking forward, and we have looked forward in our business plan and even beyond there—5-year business plan, 10-year look ahead—the revenues in the Postal Service look to be relatively stable at about $65 billion, $66 billion, and that is given a volume decrease of about 5 percent annually in first-class.

That includes single piece and commercial, fairly stable volumes in our standard mail, with some package volume increase. We have been experiencing a substantial package volume increase and we think we will see that for the near-term future.

Now, given that the other thing that we have to consider is the fact that even though we have taken substantial costs out—300,000-plus people in the last 10 years, 200,000 of them in the last 5 years, and substantially reduced the costs bending the cost line by $16 billion—we are still facing substantial problems going forward.

The key issue, even if we get to the point where we are debt-free, every year with a cost base of $61 billion or $62 billion that we have, we will be facing inflationary costs, at 2 percent, of about $1.5 billion a year. So we have to figure out what we can do going forward.

Now, we think that you cannot cut your way out of this problem. I agree 100 percent with you. I think that the Postal Service has taken some very good actions in the last few years, not just in the area of packages, but in the area of mail.

Just this week we are spending our time in the field—I was in Minneapolis yesterday for Postal Customer Council Day—and we are spending a lot of time with our customers out there, talking to them about how you actually start to merge the technology of the Internet with mail so it is relevant, so it is actionable, so you get some of the mail. That piece of mail you had, it would be great if you could order boxes with one click off of your smart phone and get that delivered. That is where we need to go from a mail perspective.

Dave's comments on pricing? We agree. We need flexibility. Our Board is responsible for the long-term health and welfare of this Postal Service and the industry. They need the authority to be able to set prices and the freedom to do it quickly. So a lot of the things that Dave has talked about, the flexibility, the speed, the market, the new opportunities out there, areas in digital—and we will talk about that in a little bit—we are in full agreement. And we think that we need the flexibility and your law gives us a very good starting point down that road.

Chairman CARPER. Good, thanks. And before I turn it over to Dr. Coburn, I will just say, as my staff has given me some numbers, they said, How many processing plants did the Postal Service have in 2008? The number is 614. How many do we have today? 323. In 1999, there were about 800,000 employees; today, I think we are just under 500,000. But we have not eliminated a lot of post offices, especially a lot of rural post offices, and I understand this is something that Senator Tester has worked on, Senator Moran worked on, others as well.

Rather than closing 3,000 or 4,000 post offices, you have come up with a way you can actually continue to keep post offices open or use these other ways in the communities, using rural letter carriers, but there are a variety of ways to continue to provide services to rural communities. They do not have any access to the Internet, have not had it, will not have it for years. But I applaud the way that you have really tried to right-size the enterprise. I think you are getting a lot closer to a sweet spot and we applaud that. Dr. Coburn.

Senator COBURN. I thank all of you for your testimony. General Williams, let us talk about the price of elasticity that you talked about. You said in general, but you said there were certain segments that are more inelastic than others. Can you quantify that for us? What are those segments?

Mr. WILLIAMS. The study showed fairly broad inelasticity. Actually, if my heart went out to somebody, it would be the small city and town newspapers. They have a very low margin, they have been hit by this wave of creative destruction that has hit all the media, and they deliver through the mail. So I would say that they would certainly meet the——

Senator COBURN. What other segment?

Mr. WILLIAMS. I think that probably at the margins, as I said, it is all pretty low, but the not-for-profit organizations will be another that I would turn to and be careful in assuring that they——

Senator COBURN. So under this bill that we have which gives pricing authority to the Post Office, can you imagine a scenario where they would not consider total revenue volume associated with price increases, and look for that sweet spot? Would anybody not look at that and try to make that determination?

Mr. WILLIAMS. No. I think that is exactly where the Governors and senior management come in. I think it would go exactly the way you just outlined.

Senator COBURN. Well, that is exactly what most other businesses do.

Mr. WILLIAMS. Exactly.

Senator COBURN. And since, as you said, the monopoly power is a hindrance now rather than an advantage, can you think of any reason why we should not have, in a bill, the ability for pricing power based on markets, competitive markets, and their competition and the service and quality of what they offer?

Mr. WILLIAMS. We believe that, as I said, the market forces are adequate and very appropriate to this situation. We are available to you and we are available to others to search out any small areas, but broadly, those are our beliefs.

Senator COBURN. All right, thank you.

Mr. WILLIAMS. Yes, sir.

Senator COBURN. There has been some criticism of that study. Can you lay out the methodology that was used in that study? You stand behind that study as accurate, do you not?

Mr. WILLIAMS. We do. We think it has been supported by many other earlier studies. There have been some occurrences that we tried to isolate and look at to make sure that those had not changed, this norm of inelasticity. We looked at the 20-year period that just ended in 2012. We tried to isolate the period before the Internet. We looked at the whole period, and then we tried to isolate the period before the Internet, early adoption. There was also a flat period and the mature adoption.

We looked at the recession. And during that period, also, there were two large price increases, in 2000 and 2001. We tried to isolate those as intervening variables and throw it up against the regression and it would not budge. It appears to us that we could definitely stand behind the study as others have.

Senator COBURN. The people that the Post Office compete with, how do you think they determine their prices? How do you think FedEx made a determination to raise their rates yesterday? Do you think they did a study and looked at what the market could bear based on the quality of service that they were offering?

Mr. WILLIAMS. Yes, sir.

Senator COBURN. Made a calculation?

Mr. WILLIAMS. I am certain they did, as well as their competitors. FedEx and UPS annually have—their increases have been about twice the rate of inflation, as ours were held inside inflation. The Postal Service's competitive side is in—they have their feet wet now and they have been involved in increases. They have increased above inflation and those areas have grown.

The British just got rid of their price cap for virtually everything. We are a pretty good deal. Worldwide we do not charge as much as the other world posts.

Senator COBURN. But we are also losing billions of dollars a year.

Mr. WILLIAMS. That is the price we——

Senator COBURN. And it is true that, I think, this week the British Postal Service becomes privatized.

Ms. Goldway, you talked a lot about predictability for rates so mailers are not caught off-guard, but in doing so with the rate cap, wasn't the Postal Service's current financial crisis predictable?

Ms. GOLDWAY. Yes, prices are predictable. Under the current price cap, yes, prices are predictable.

Senator COBURN. The crisis that we face, was it not predictable?

Ms. GOLDWAY. Well, I guess it was not predictable, no.

Senator COBURN. I would like to enter into the record my statements from a hearing in 2007, which I will give to the clerk in a moment.[1] It was predictable. I predicted it. When we passed the last Postal bill, I said we would be back here because we are not setting up a competitive market force, an independent organization that can respond and compete with what they have to compete with, and that markets ought to determine rates, where they can, and we do not allow the monopoly.

Because it is no longer a force. It is an asset in terms of what the Post Office can do in terms of an asset that they can sell for—they can deliver better anywhere else, anywhere in the country. They go the last mile. So that is an asset. But the risk of a monopoly power of the Post Office is gone.

So we now have in front of us an organization that is price controlled and labor controlled. And I can tell you, we are never going to solve the problems of the Post Office if those two things stay there. So what we have to have is fair treatment for the employees in the Post Office and flexibility for the Post Office to maximize its return on the service that it has to sell.

[1] Statement for the Record is in the Appendix on page 223.

So my question again is, talking about predictability for rates for the mailers, but that predictability led to a predictable consequence and that is billions and billions and billions of dollar losses. I would enter into the record the number of Postal employees since 1926[1] and the attrition that has happened because of this. And yet, the cost reduction still is not good enough because we have no pricing power that is market-based. We have no pricing power that is market-based. So I would ask that this be entered into the record as well as my statement from 2007, 4 months after the last Postal bill was passed.

Chairman CARPER. Without objection.

Senator COBURN. I want to talk to you about a touchy subject with your employees and it is called arbitration. In our bill, it is presently the law that an arbitrator cannot consider the financial health of the Post Office in arbitrating a labor dispute with the Post Office. Is that correct?

Mr. DONAHOE. That is correct.

Senator COBURN. Do you know of any business in the world that could be successful in negotiating their labor contracts when they, in fact, cannot consider their financial health when they negotiate their labor contracts?

Mr. DONAHOE. No. In a situation where you have binding arbitration, you have to consider not only the current financials, but you have to look ahead. And that is what we are asking for with this legislative, the ability not only to look at it from an arbitrary perspective, but to make some changes, in the bill, around employee retirement costs and everything else, because we know the revenues will be fixed at about $65 billion to $66 billion and we have to control these costs.

Senator COBURN. All right. I am out of time. I will come back.

Chairman CARPER. Thank you, Dr. Coburn. Let me just go down the list to welcome Senator McCain and Senator Pryor. Next was Senator Johnson. He is next in line when he returns. Senator Tester, you are next, and after you, Senator Heitkamp, Senator McCain, Senator Pryor. Thank you.

OPENING STATEMENT OF SENATOR TESTER

Senator TESTER. Thank you, Mr. Chairman and Ranking Member Coburn, and I want to thank the panel for being here today. I agree you guys need better price flexibility. There are no ifs, ands or buts about that. I would also say that if the goal here is to privatize the Postal Service, then we ought to have a bill to do exactly that and move forward. I think it would be a mistake, but nonetheless, we ought to have that debate, change the Constitution and do it and move forward.

My concern revolves around rural America. The Postmaster General knows that. We have talked many times. I believe that some of the best customers of the Postal Service happen to live in rural America. They really do depend upon it. As of July 1, 2002, the Postal Service changed its delivery standards for much of rural America. Dakotas, Montana, Nebraska, reductions were made in

[1] The chart referenced by Senator Coburn appears in the Appendix on page 331.

the alternative means of transportation, and as a result, in those States, overnight delivery is almost impossible.

In fact, I would say—and I got that flyer, too, that the Chairman got. It was a good flyer. But I would question whether you could have overnight delivery to my house in Montana on a weekday, but much less on a Saturday or Sunday. I would love to see it happen. I do not think it is possible right now.

And the reason is, is because those standards have changed. Many of the processing facilities are gone in the rural areas because of volume. I mean, you guys made the call and I understand that. I think it was a mistake, but the call had to be made one way or the other. And then the Postal Service continues to tell me that the reduction in hauling mail by plane has not impacted these delivery standards.

So the question I have, to get to the question, is, were there any studies conducted before the July 1 reduction in the alternative methods of transportation services?

Mr. DONAHOE. Yes, Senator, we go through what is called an area mail processing study and we take a look at everything—all the effects, the cost savings that come out of that, and any service interchanges that we have had proposed.

Senator TESTER. Did those studies indicate that those reductions to services would not impact rural America?

Mr. DONAHOE. The studies that we have put together show where we have to make service standard changes in order to get the savings out of the reductions. We have made those and we have maintained overnight service in large portions of rural America.

Senator TESTER. So what you are saying is, the study—and I do not want to put words in your mouth. The study indicated that there would be minimal impacts by this? Is that fair to say?

Mr. DONAHOE. It depends on how much of a change you are going to make.

Senator TESTER. With the changes that you actually did make. I mean, because the changes have been made. They are real life changes now.

Mr. DONAHOE. Right.

Senator TESTER. Did the studies indicate that if you made those changes, because you did it proactively——

Mr. DONAHOE. Right.

Senator TESTER [continuing]. That it would have minimal impact on service in rural America?

Mr. DONAHOE. Yes, it would. As we have made changes in service across the country, we started with the premise that about 40 percent of all the mail that we delivered was overnight. The goal was to maintain as much of that as possible. With the first round of changes, we have been able to maintain approximately 35 percent.

There were some places we had to downgrade from 1-day to 2-day. Again, it is about 5 percent of the total volume. But we have been able to maintain overnight service in rural areas.

Senator TESTER. OK. I get you back to rural America—I get back to Montana, rural America, every weekend. I go back, travel the State. In August, we got a chance to do some pretty extensive traveling. And I can tell you that almost with every stop, I did not hear about delays of 1 day. I have heard mail delivery takes 3, 4, or 5 days.

And I can tell you, my wife and I just mailed a mortgage check on Monday and I said, It is not going to get there. It is not going to get to where it needs to go by Wednesday or Thursday. It is going to be a week. And we are probably going to get dug for that, and that is not the old mail service we used to have, to be honest with you, and that is where my challenges are.

If we get fined for that, then bring on UPS and FedEx because I cannot do it. Do you see what I am saying? And that is the challenge. So my question is, look, there is not anybody that lives out there. There is a million people in the whole State of Montana. And how many people live in Pittsburgh? A million people, more than that?

Mr. DONAHOE. Two.

Senator TESTER. Two million. So if you are looking at a business model that is based upon where you are going to make your money, you are probably not going to make a lot of money in Big Sandy, Montana. The question is, the Postal Service was set up to serve people, I think. Is that taken into the equation when we are closing mail processing centers, we are not using planes to move mail in rural America? Are those kind of things taken into account?

Mr. DONAHOE. Absolutely.

Senator TESTER. And so, what is the answer when the postal standard has changed from overnight, 1 to 3 days, to 3 to 5? Is that deemed acceptable?

Mr. DONAHOE. No. We have not changed any service standards to three to five, except in areas where we go, say, in Alaska——

Senator TESTER. I got you on that, right? But the reality is, it has changed, and I am not going to put words in Heidi Heitkamp's mouth, but my guess is she can verify it in North Dakota, too, because those five States—I think there were five—were the ones that the standards were changed in. And it is closer to five than it is to three.

Mr. DONAHOE. We measure our mail—whether it is standard mail, first-class, periodicals—everything that is measured has continued to either stay at, or improve on, service levels, as well as Priority Mail. I would be more than happy to sit down with you and share all the data. We take our universal service responsibility very seriously. You have never heard me talk about not doing that, but we are faced with a financial crisis——

Senator TESTER. I got you.

Mr. DONAHOE [continuing]. To try to figure out how to keep our head above water.

Senator TESTER. And all I am trying to get to is if I am swimming upstream here and the goal here is to maximize profitability at the expense of rural America, just tell me.

Mr. DONAHOE. No, it is not. It is universal service. It is to keep mail service affordable, not become a burden to the American public, be able to provide reliable, responsible service, and eventually, through this legislation get the cloud of financial turmoil away from us.

Senator TESTER. OK. I would just tell you, I do not doubt that your studies say what they say. I do not doubt that a bit. I can tell you, in reality, because I live there over half of my time. I live on that farm 12 miles west of Big Sandy. I can tell you, in reality, it ain't working that way, not in that place.

And I do not ask for any special treatment, by the way. I do not want special treatment. I just want to be treated like my neighbors. So if I am being treated that way, so are my neighbors. So I bring that up. Just take a peek at it to see what you think.

Mr. DONAHOE. Absolutely.

Senator TESTER. As this legislation moves forward and we have that debate—and just one more question and then I will kick it over—is there going to be further consolidation of mail processing centers or post offices while we are having this debate in Committee or on the floor?

Mr. DONAHOE. No. The bill, as it is written, puts a 2-year freeze on mail processing facilities. We have some scheduled for 2014. We would not advance any of those things to try to get under the wire. From a post office perspective, when I visited out in Montana last year, people told us, Keep our office open, keep our local identity. If you have to change window time, we understand that, but give us access to mail. We have done that.

Senator TESTER. Fair. So what you are saying is, there would not be any post offices closed or mail processing centers closed while we are debating this bill before it becomes law?

Mr. DONAHOE. No. We have done what we needed to do for this year. Any further changes would require us to service the interchange and we will not do that.

Senator TESTER. Thank you for your patience, Mr. Chairman.

OPENING STATEMENT OF SENATOR HEITKAMP

Chairman CARPER. You bet. Thanks for those questions. Senator Heitkamp.

Senator HEITKAMP. Thank you so much, Mr. Chairman, and Ranking Member, Dr. Coburn. No big surprise here. We are just going to follow on to Senator Tester's testimony. And I just have a basic question, and I do not mean to be sarcastic about it. But I need an answer from you, Mr. Donahoe. Do you believe that the highly rural areas of America deserve the same level of service as suburban and urban areas of this country?

Mr. DONAHOE. I do, and I believe that even the offshore areas like Hawaii, Alaska, and Puerto Rico do, and we consistently measure and stay on our mission to provide universal service. I believe that fully.

Senator HEITKAMP. And I believe you believe that answer. But there is always a constant discussion that we have about what your studies show and the reality of what our constituents experience dealing with the post office. And I want to just followup on what Senator Tester's discussion was about having an expectation that, if you put your mortgage check into the mailbox and it is picked up, you will, in fact, be able to pay your mortgage on time if it is due 3 days from then.

And I do not think that anyone in rural America anymore believes that is true or trusts it. And it has created a sense that the constitutional obligation that was recognized, the importance of the Postal Service, the importance of offering this opportunity to every place in the country is not being met. And so, I do not want to belabor that point. I do want to tell you that you can do all the studies in the world, but that is not the experience that people are having in rural America.

The other question that I want to get to, and it really goes to the future of the post office and the future of the Postal Service, you heard Mr. Williams relay a lot of opportunities, and I have been on this Committee now for a very few months, certainly do not have the extent of the experience that the Ranking Member and that the Chairman have on this debate.

But yet, I constantly hear good ideas, what seem like good ideas that ought to be explored about how we can make the post office more relevant, and certainly rural post offices more relevant. So I am curious, in the last 12 months since I have heard all this discussion, what steps have you taken, as the Postmaster General, to identify and recognize and begin to implement some of those good ideas? Give me three examples.

Mr. DONAHOE. Well, let us start with Priority Mail.

Senator HEITKAMP. Priority Mail has been around a long time. I have used it a lot.

Mr. DONAHOE. Right.

Senator HEITKAMP. I am talking about innovations, not Priority Mail. I am talking about different kinds of things, whether it is digital—and you heard Mr. Williams give you a whole litany of ideas.

Mr. DONAHOE. Right.

Senator HEITKAMP. I want to know, in that space, what you have done.

Mr. DONAHOE. I will start with digital.

Chairman CARPER. Could I interrupt, please, for a second? Let him do four, because what they have done, they have re-branded Express Mail, and I think in a very smart, thoughtful way that can grow revenues by a half-billion dollars or more a year.

Senator HEITKAMP. Mr. Chairman, I get that. I am a faithful user of the mail service. I have used Priority Mail. It is easy, it is the packaging I agree with. But obviously, those moves have not made the post office more lucrative or have not solved the problems that we have today. So I want to know about other innovations.

Mr. DONAHOE. Well, they have made the post office more relevant. Our revenue off packages alone has grown about $1.5 billion in the last 3 years. That goes a long way.

In terms of digital, we have established a digital group. We are working with a very good contractor in that area, In-Q-Tel. We, as a matter of fact, have just been awarded the contract, the first contract ever, to be the intermediary within the Federal Government on what is called the F–6 Program. We are very active in the digital area around starting to work on products that would help to set a platform for authentication of who you are. Just like Mr. Williams mentioned, the work is already being done right now in terms of getting on the Internet.

Secure digital messaging, there is a lot of work to be done there. We think that there are big applications in the health care world, the financial world, and for personal services. We also are exploring the whole concept of digital vaulting with our contractor. That is digital.

Senator HEITKAMP. And when you did those projects, and you looked at them, what is the revenue benefit of those?

Mr. DONAHOE. Five year projects $758 million.

Senator HEITKAMP. For which projects?

Mr. DONAHOE. For that digital set of projects. We have worked with In-Q-Tel and we have done work with their marketing group. We have a business plan that is established with a pro forma look ahead for 5 years, and the financial gains that we think we can have in 5 years are about $758 million. A lot of work has been done.

But I will tell you, I have not spent a lot of time publicly talking about all of those types of things because the bottom line is that we have to address the cost factors in this organization. You can grow a business like digital, a billion dollars; we introduced a product 2 years ago called Every Door Direct, part of our standard mail. We have grown that $800 million off of a base of zero in 2 years.

Inflation in our organization pushes costs by $1.2 to $1.4 billion a year. We have to get after the costs as well as innovation and growing new products.

Senator HEITKAMP. Would you agree that some of what you would need to do in terms of looking at cost containment, business plans, and business models without incorporating or merging the sense of what the new lines of revenue could be, you could be making decisions on the cost side that would greatly reduce or eliminate your opportunity to be relevant in a new product line? Would you agree that is true?

Mr. DONAHOE. No. I think that there are big opportunities right now. As we work with mailers—I spent yesterday in the State of Minnesota in Minneapolis. We talked specifically with 300 customers about the growth of mail. Mail has to be relevant——

Senator HEITKAMP. I only have a few more seconds here, but I do want to point out that if you close every rural post office in North Dakota, you will not have an opportunity for new revenue.

Mr. DONAHOE. There is no proposal to close any post offices. As a matter of fact, in your State, we are expanding some post offices, Williston and a few others, because of the oil boom. We are responding to that and there is no interest in closing post offices. You have never heard me say that. We have made changes of the PostPlan that helps us from a bottom line perspective, but it gives customers what they are asking for, access to the post office and rural town identity.

Chairman CARPER. Senator Heitkamp, thanks for those questions and for your passion for these issues. Senator McCaskill, if you are ready, you are next in line. We had a couple people who have come and gone and they may slip back, but you are next up if you would like.

OPENING STATEMENT OF SENATOR MCCASKILL

Senator MCCASKILL. Well, this is an occupation where about half the time we all pretend we are ready even when we are not, do we not? So I think I will go ahead and ask questions. I am ready.

Chairman CARPER. You have never had a problem with being ready.

Senator MCCASKILL. I am ready. I want to talk a little bit about the expensive part of our infrastructure, and really what is a reality. I obviously have come out strong for 7-day delivery. I believe it is a competitive advantage we have and that if we give up that competitive advantage it is a mistake, to give up that competitive advantage because this is now a competition. We are competing.

One of the things that I need clarification on is what we are charging our competitors. The growth in the UPS and the United States Postal Service is going to be in packages. I mean, it is pretty obvious. I know in my life, I spend a lot more time clicking than I do driving in terms of shopping.

So if we are competing for package delivery, the growth area, answer this question for me, Mr. Donahoe. Is, in fact, UPS paying less to go down that last mile than I am? Are they not using us for their last mile of delivery in the rural areas? Are they not using our infrastructure, our competitors?

Mr. DONAHOE. Yes. UPS, FedEx, and a number of private companies use us for last mile. It is called Parcel Select. Drop at the post office, you get your mile delivery.

Senator MCCASKILL. And do they get it cheaper than I get it?

Mr. DONAHOE. Well, there is no real access for you to have on that product, unless you would actually bring it to the post office. If you were mailing——

Senator MCCASKILL. No. If I am sending a package to a friend of mine in rural Missouri——

Mr. DONAHOE. Right.

Senator MCCASKILL [continuing]. Is my cost less expensive or more expensive than what you are charging your competitor?

Mr. DONAHOE. Different products. You would use Priority Mail. If a flat-rate box, you would pay somewhere over $5 depending on the size of the box. That takes advantage of our whole network. We collect it, we process it, we transport it, we deliver it. What happens with UPS, FedEx, and some other customers, they bring mail and sorted already to the ZIP code, drop it with us, our clerks sort it and carriers deliver it. It is only a small portion of the work, so you do not charge somebody the entire amount for a small portion of the work.

Senator MCCASKILL. Well, I guess what I am worried about is that we are not seeing them as a competitor, that we are seeing them as a customer. And they are surfing off the most expensive part of our Internet, of our architecture. I mean, they are using the part that is costing us so much money. And I do not feel like the agreements that you have entered into with them treat them as a competitor, but rather, treat them the same way you treat every other customer. Is that an unfair characterization?

Mr. DONAHOE. No. We have costed these agreements out like any other business. The fortunate thing about our package business, it is competitive so we can enter into contracts and these contracts make money for the Postal Service. The package business is a very competitive industry. UPS versus FedEx versus other companies like LazerShip, who nobody even talks about. LazerShip is out there competing with people making $10 an hour. It is very competitive. Price, affordability, dependability, visibility is critical to win in this package game.

Senator MCCASKILL. But they are using you because you are cheaper than them doing it themselves.

Mr. DONAHOE. We have increased the market share in the package business by two points. We have also secured a substantial number of customers coming in for the Last Mile Delivery that have bypassed some of the other competitors. We have grown our business.

Senator MCCASKILL. I think you understand the point I am making.

Mr. DONAHOE. Sure.

Senator MCCASKILL. I mean, if you spend—if this is a telecom company and they have, in fact, are a whole sector of telecom, the people who worked and did the infrastructure, they are getting a huge payoff for the infrastructure from their competitors, a huge payoff, especially in rural areas. And we have done all kinds of things to assist with that.

I really want to know what the specifics are of the agreements. I want to know what your competitors are paying for the——

Mr. DONAHOE. We would be more than happy to sit down——

Senator MCCASKILL. The irony is, it is the most competitive part of the business, it is where the most growth is, but I do not sense that you are exacting a competitive advantage based on the fact that we have made the investment, the United States Postal Service has made the investment, in the delivery system they must use. Why do we not have them do it themselves?

Mr. DONAHOE. We would be more than happy to sit down and——

Senator MCCASKILL. Do you know who would be cheaper then? If they had to do their own Last Mile Delivery, guess who would be cheaper.

Mr. DONAHOE. We know we are cheaper and that is why they use us for Last Mile Delivery.

Senator MCCASKILL. Guess how much cheaper we would be. A lot cheaper.

Mr. DONAHOE. We are pretty cheap now. We are the best value out there for anybody mailing a package, Priority Mail or anything else.

Senator MCCASKILL. I would like to get the specifics of the agreements that we have with our competitors on package delivery——

Mr. DONAHOE. We will sit down——

Senator MCCASKILL [continuing]. And I want to make sure that we are taking advantage of what we have as opposed to stuck in a mode that they are just other customers.

Mr. DONAHOE. I think it will be valuable to show you what we do, what we do with some of the large contracts like FedEx and UPS. I think it would be good to see what LazerShip and some of the other competitors charge, too. It is a very competitive industry.

Senator MCCASKILL. Have you modeled out what would happen if you decided not to carry their packages for them? Have you done an economic model of what they would have to charge to send their packages versus what we charge?

Mr. DONAHOE. No, we have not done that. I am sure they have done that model and they make the decision using us based on what their prices are.

Senator MCCASKILL. But we are the ones that have it. We have the architecture. Why have we not modeled it out?

Mr. DONAHOE. Well, think about it this way. If our letter carriers and rural carriers are driving down that road every day, 5 days a week for mail in the future, 6 to 7 days a week for packages, it is in our best interest to have as many packages on that route as possible. That is our goal.

Senator MCCASKILL. But the goal——

Mr. DONAHOE. And we have to do it at the most reasonable price, which we have very smart people in our organization that have put those prices together. We are not giving anything away, but we have to take full advantage of the network and load that network up with as much mail and packages as we can. That is why we are here. We have lost 27 percent of our mail volume. You have to make some changes——

Senator MCCASKILL. Exactly right. And, Mr. Donahoe, what I am asking you to do is what any business would do. Model out what they are going to have to charge if they do not use you versus what we charge, and that is the way we would carry more packages. We would get more of their business.

Mr. DONAHOE. That is true in some cases, but to a large extent—I will give you an example. One of the competitors right now uses a model that determines whether we get the packages or not based on the density of the route that they have on any given day. That is how technical and how advanced the technology is. So some days we get it, some days we do not, based on how many packages are in a certain city block.

This is not just on a whim, giving us mail on 1 day, or not. It is very specific, it is very technical, and our people, I think, have done an excellent job pricing and growing this business to grab a large chunk. We have picked up two points in the package business in what is a very competitive environment.

Senator MCCASKILL. And I think that you are not using every advantage you have in that competitive market. My time is up for this round. I have a lot of other questions for the record.

Mr. DONAHOE. We will be happy——

Senator MCCASKILL. At a very minimum, you should be doing the modeling as to what it would look like if you no longer allowed them to use our carriers and whether or not we could get a competitive advantage.

Mr. DONAHOE. We have best guesses, but it is not perfect. But believe me, the technology is there to make it a lot more specific on a daily basis. We will come over and sit down with you.

Senator MCCASKILL. That would be great.

Mr. DONAHOE. Thank you.

Senator MCCASKILL. Thank you, Mr. Chairman.

Chairman CARPER. Sure. Dr. Coburn, go ahead.

Senator COBURN. Just a little comment. By statute, you cannot sell that product below your cost.

Mr. DONAHOE. No.

Senator COBURN. So there is no subsidy now that is achieved for that that is transferred to other mailers because we are doing this. This is gravy for them. By law, they cannot give UPS or FedEx a price below their cost.

Senator MCCASKILL. I do not want them to. I want them to give them a higher price on the cost.

Senator COBURN. I understand that, but that is a market-determined price. So there is no subsidy. As a matter of fact, packaging business is subsidizing the rest of it now.

Senator MCCASKILL. I get that. I think you and I can discuss this, but I think we would agree. I probably was not as articulate as I should have been trying to make the point. I am not asking them to charge them less. That is the issue. I want them to charge them more because they are using something we have and we would gain a competitive advantage by charging them more.

Senator COBURN. Well, actually, I actually think they have done a pretty good job in what I have looked at in terms of pricing their product to get as much volume as they can. The higher the price goes, the lower their volume goes and that is, again, giving them the ability to make a decision based on the price elasticity of the market they are in to get as much as they can, and there may be, in this area, some real inelasticity as far as the lower end on the price.

Senator MCCASKILL. That is why I want to look at all the specifics.

Senator COBURN. That is what this bill is all about, to give them the flexibility so that they can get the most revenue based on this wonderful asset that we have called the U.S. Post Office.

Senator MCCASKILL. I agree with that. I do agree with that.

Chairman CARPER. Thank you. I think that was a good exchange. Chairman Goldway, you have not been getting enough questions here. We are going to ask you at least one. But Mr. Williams argued a few minutes ago that the Postal Service could change prices without losing volume. Dr. Coburn says that the monopoly is not what it was.

My question of you is, to what extent do you believe that the Postal Service still has monopoly power over certain mail products? What does that say about decisions that we ought to make about retaining or changing the system for postal rate regulation? And I am going to ask, after you have responded, I am going to ask the Postmaster General to get involved in this and come back to Mr. Williams as well. Please.

Ms. GOLDWAY. I think it is a very important issue that you have raised.

Chairman CARPER. If you think about it, the PRC was not always the Postal Regulatory Commission. For many years, it was the Postal Rate Commission.

Ms. GOLDWAY. Right.

Chairman CARPER. They had a very different role than they have had in the last 6, 7 years.

Ms. GOLDWAY. And I think this matter can be discussed and debated by many people. What our staff has indicated is that there is still a strong monopoly when it comes to letter mail and those products that the Postal Service has a market-dominant position in. If you are a non-profit organization and you want to communicate with a paper product, your option is only one and that is to go through the Postal Service. You do not have another option.

So studies that determine what the price elasticity and inelasticity in the future will be, when we have been operating in a monopoly system for the last 100 years, are not necessarily reliable. And it seems to us that the Postal Service cannot have it both ways.

It cannot say that this is a competitive market and if you let us have competition without any regulation, we will not raise prices more than we need because there is competition that will keep prices down. On the other hand saying, there is price inelasticity and it is OK if we raise prices because we will keep our volumes up because there is no concern about that. There is constant demand.

You cannot present both arguments. So it seems to me, if you want to eliminate the monopoly and allow prices to fluctuate and get their sweet spot, as we have done with the competitive products that the Postal Service has done where they have raised prices over 5 percent a year, then you do that.

But if you ask first-class mailers, if you ask people who send greeting cards, if you ask people who are non-profit mailers whether they can manage with a 5 percent price increase, you are going to get responses that say they simply cannot do it and that, in fact, you will lose so much volume that you will not get the revenue that the Postal Service thinks it is going to get from that mail.

Further we believe in the Commission that the price cap regime has created the stability and transparency and accountability that has given mailers some assurance in a time of real transition, and has given the Nation's users the sense of trust in the mail, which is very important to the Postal Service brand and its future.

Chairman CARPER. I would welcome the thoughts of General Donahoe on this. Sort of the implicit question is, what is the role of the PRC going forward? It is not what it used to be. Maybe it is not what it is today, but what should it be? And I appreciate what you just said, Madam Chairman.

Mr. DONAHOE. You know where we stand. We put a white paper out on our role around Governors in general. The key for us from a Governor's perspective is this: If you are putting the responsibility on the Governors and management of the Postal Service to run the organization, we should also have the authority to make choices and changes on prices, service, and products, and do it with absolute speed.

This world has gotten faster and faster. Every day that we look around, you think about the changes that have happened just in the telephone and computer industry, and we are in the same exact environment. Our feeling has been that we have a very reasonable and responsible Board of Governors. They will not make decisions that put the organization out of business. They will not make decisions that hurt the industry.

We think that we should be in a situation as spelled out in your bill that has a lot of flexibility around a cap, potentially no cap at some point in time, and the ability to have after-the-fact review with the Commission. We have no argument that the Commission should be there to take a look at things—decisions that we make—like a public rate commission does today, and we would support that 100 percent.

Ms. GOLDWAY. Could I just——

Chairman CARPER. Madam Chairman, go ahead, and then we will go to Mr. Williams.

Ms. GOLDWAY. Because the Postal Service is a federally owned enterprise and is exempt from many of the State and Federal regulatory laws, the law governing the Postal Service includes in it a provision that there can be no refunds. The Postal Service is exempt from giving refunds. If it establishes rates that are determined to be in some way unlawful, given the various requirements that are still in the law that you propose, how does a complaint mechanism solve that problem, an after-the-fact complaint mechanism. It is a question. You may be satisfied with it, but it is a question that we hear from stakeholders.

Chairman CARPER. Dr. Coburn said that could easily be added to the bill and I appreciate the element. Let me go to Mr. Williams before my time runs out. And then we recognize Senator McCain. No, not just yet. One more minute.

Mr. WILLIAMS. I think increasingly we find ourselves in a very fast, very unforgiving environment and we need tremendous agility. There are sudden threats and there are perishable opportunities. The Postal Service needs to be able to move in an agile manner to operate and navigate inside that environment or they will disappear, and if they cannot do it, they should disappear.

There are a lot of alternatives to messaging of all sorts today. In advertising, there has been television, radio, newspaper, and now an aggressive Internet market. And personal communications, texts and tweets and wall posts have fabulous features to them. Bill payment companies are aggressively moving to cut back office costs by driving people to the Internet.

In parcels, actually, we are the ones that are breaking the monopoly. The Postal Service got into parcels in order to break some of the mischief that was occurring between the parcel companies and the railroads. So I believe that efficient market forces should always be used when it is possible, and I believe in this environment, it is possible and it is the ingredient that is needed to move the Postal Service forward.

Chairman CARPER. Thank you. Senator McCain, welcome.

OPENING STATEMENT OF SENATOR MCCAIN

Senator MCCAIN. Well, thank you, Mr. Chairman. I want to thank you and Senator Coburn for this product which, I think, is a very important one and an issue we have been wrestling with for a long time. The fact that you and Senator Coburn have come together to craft this language with compromise, I think, which Senator Coburn is very well known for is a model, as you know, of compromise here in the Senate.

I do want to thank both of you for putting together this legislation which is urgently needed to remedy a very serious situation in a broad variety of ways. I thank you both for working this out and I look forward to supporting it in any way that I possibly can.

Mr. Williams, you just made a very interesting comment. Five years ago, the whole means of communications in America was vastly different than it is today. I think you could argue that 5 or 10 years from now, it may be again very different from what it is today. And you made the argument, and I think it is valid, that we have to have an enormous amount of agility in order to keep up with these incredibly ever-changing methods of communication. Is that an argument, in your mind, to privatize the Postal Service?

Mr. WILLIAMS. The United States is, so far to date, has picked a different route and it has been——

Senator MCCAIN. The Europeans have chosen a different route, right?

Mr. WILLIAMS. They have in halting manner. They are sort of going forward as quickly as they can and they pause when they need to. In the United States, they have joined with the private sector in public/private partnerships and co-opetition which definitely—Senator McCaskill's comments were absolutely fascinating. So I am not sure what the road is ahead. Privatization or——

Senator MCCAIN. Then if you are not sure of the road ahead, do you have confidence in this legislation, that it can accommodate the road ahead?

Mr. WILLIAMS. I do. I think it is a good piece of legislation. If I was worried about anything, and I am not worried sick, it would be that we do not quite have it balanced yet. We are still trying to match demand with supply. We still have a ways to go. The bill seems to want to pause that with regard to the closure of additional plants and post offices. That is the part I look at with some worry.

I also see some value in it. It might be good to pause, but we are losing money, we are accumulating debt, all of our money for innovation is gone, we need to arrive as fast as we can at this balance and then return to normalcy.

Senator MCCAIN. Thank you. Mr. Donahoe, you have earned the praise of Senator Coburn for all the work you have done in helping craft this legislation with him and Senator Carper. I can assure you that is very hard to come by. So you should appreciate it. I want to thank you and I want to thank the panel for the work that they have done.

But given the fact that 80 percent of the Postal Service costs are associated with labor, how important is language in this bill that would require the financial health of the Postal Service to be a consideration during arbitration of labor contracts?

Mr. DONAHOE. I think it is very important. I think the key for the Postal Service——

Senator MCCAIN. Very important and very controversial, right?

Mr. DONAHOE. It is controversial. There are a lot of things in the proposed bill, and things that we have put white papers out on that are very controversial but needed. When you look ahead in this Postal Service, the whole idea is long-term, comprehensive legislation and it cannot be halfway. So if we are going to address these issues, we have to address long-term costs like retirement costs, like some of the issues that we face today from a workforce environment.

I think the key thing to keep in mind, from a labor perspective is this: If we deliver mail to every door 5 days per week and process mail through the system and deliver packages 7 days per week, we will have to have people to do that. So labor costs will always be large. The key thing is not so much the percentage of labor costs. It is shrinking the total cost of the organization and that is what we aim to do.

We have made very good progress with the unions over the last couple of years with substantially higher rates of non-career employees, which helps the bottom line. Good people come in, they get jobs, they are a lot more affordable. We need to continue that work to make our retirement systems more affordable. Next week we are going to talk about health care.

There needs to be dramatic changes in the health care proposals for the Postal employees, which should apply to all Federal employees, to make it more affordable. That is the way we need to go. We need to be courageous and we need to be bold and we need to make this happen.

Senator MCCAIN. You made reference to the issue of 5-day mail delivery, and in your testimony, you said the American public overwhelmingly supports moving to a 5-day delivery. This legislation has a moratorium on that. Do you think that is just a matter of compromise or do you think that is a good idea or bad idea?

Mr. DONAHOE. I think it is a matter of compromise. I would love to be in a situation where next Memorial Day we move to a 5-day schedule. It is the perfect time. Mail volume is down low. It is a good time for us to make the transition and it saves us $2 billion a year. The American public, in every survey that we have done, has been fully in support. I think the lowest percentage is 70 percent.

We have some survey information that says 80 percent-plus of Americans think it is a good idea, versus closing post offices and raising prices.

Senator MCCAIN. For the record again, you believe that the Carper-Coburn bill gives you the flexibility that you need to achieve the billions in cost reductions that are necessary to sustain the Postal Service for the long term?

Mr. DONAHOE. It gives us the flexibility and the speed that we need. The one thing that is missing is the requirement to use Medicare as a primary for health care for retirees. We are going to talk about that next week. I will make a pitch that it has to be mandated. If not, we do not hit the financial numbers that we need to hit. Our business plan lays this out. If we follow what we need to do from a business plan perspective, we will get this organization back on good, firm financial footing.

Senator MCCAIN. And you agree with that, Ms. Goldway?

Ms. GOLDWAY. I certainly respect and admire and support the efforts that the Postmaster General has made with regard to cost-cutting. I think the levels of efficiency and savings are quite remarkable. But I do not and my Commission does not endorse all of the aspects of this particular law.

Senator MCCAIN. So would you submit for the record the areas that you do have concerns with?

Ms. GOLDWAY. Well, I think our testimony——

Senator MCCAIN. I know your testimony, but it is very helpful for us to have in writing your exact concerns. Would you do that?

Ms. GOLDWAY. I will be happy to do that.

Senator MCCAIN. Thank you very much.

Ms. GOLDWAY. Thank you for the opportunity.

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

Chairman CARPER. Those are great questions. Thanks so much, Senator McCain, for your support. In Arkansas, they always say, when they say hi to people, they say, Hey, man. So that is why I say to him every time I see him. Senator Pryor, you are recognized.

OPENING STATEMENT OF SENATOR PRYOR

Senator PRYOR. Thank you, Mr. Chairman, and I want to thank you and Senator Coburn for your work on this.

Ms. Goldway, let me start with you, if I may, on the Postal Service Advisory Opinion Process. I know there has been some questions about how long it takes and why it takes so long, but let me ask you about, from your standpoint, the value of providing a non-binding advisory opinion. What is the value in a non-binding opinion?

Ms. GOLDWAY. Well, I think we have had many examples brought out today. The Postmaster General talks about the fact that the Postal Service has decided to maintain post offices in rural America. They did that after coming to us with a proposal to close 3,600 rural post offices. And the discussion that we were able to provide and the open forum of the advisory opinion process and the recommendations we gave them suggested that they provide an alternative, adjusting hours, and that is what they have done.

So I think that the point of these advisory opinions is to give the Postal Service a better opportunity to get an honest review of what their proposals would be to change, rather than barrel ahead with what their initial proposals are. The same could be said for the 6 to 5 day delivery. When we reviewed that and highlighted many of the problems that rural America would face with eliminating the sixth day, we talked about packages, particularly prescription drugs, and as a result, the Postal Service has adjusted what it now proposes to do with going to a 5-day delivery pattern.

There are problems with the advisory opinion process. It can be lengthy. There is a lot of opportunity, we think, to streamline the processes, and the Commission has introduced rules to reduce the litigious nature of some of the processes so that we can make decisions in a more timely fashion. We hope to do that.

But we do believe that the transparency and accountability of the Postal Service is maintained when you have this advisory opinion process included in the public policies of the government.

Senator PRYOR. From your standpoint, is there value in these advisory, non-binding advisory opinions?

Mr. DONAHOE. Yes. We take the advisory opinions very seriously. We also solicited our customers, to Chairman Goldway's point, with post offices. We spent some time in the field in a number of different places and people told us, Hey, if you can keep the post office open, if you can make it more affordable from changing the hours, we are OK with that, but please keep it open. And we balanced that with what we got back, too, from the Commission.

Senator PRYOR. Let me ask you a followup on one of Senator McCain's questions. He made a statement and I just want to know if it is accurate. He said that 80 percent of postal costs are associated with labor. Is that right?

Mr. DONAHOE. 78 percent.

Senator PRYOR. 78 percent of postal costs are related to labor?

Mr. DONAHOE. Yes.

Senator PRYOR. Is that anything in addition to just the hourly, the wages and the salaries and the benefits, et cetera? Is that what that is?

Mr. DONAHOE. It is salaries, benefits, as well as the amount of money that we put away for retirement and health care. Now, on top of that is the retiree health care pre-funding. That represents about 5 percent. So if we resolve that, our percentage of employment costs in terms of total would be about 73 percent.

Senator PRYOR. And remind the Committee again about your numbers of employees. I know you have been shrinking your workforce. So let us say, 10 years ago, 5 years ago versus today, how much have you shrunk your workforce?

Mr. DONAHOE. High point of employment in the years late 1999, 2000, we had 804,000 careers employees with about 100,000 noncareer. Today we have 490,000 career employees with 120,000 noncareer. So there has been about 308,000 reduction in total career employment.

Senator PRYOR. What is that, about a 35, 40 percent reduction?

Mr. DONAHOE. It is almost 40 percent, yes.

Senator PRYOR. And also, while I am thinking about a followup, let me ask about some cost savings. I know over the years, we on this Committee and in other contexts here in the Senate, we have talked about the possibility of you guys going to natural gas vehicles. Do you all have an initiative on that?

Mr. DONAHOE. Yes, we do. We are working with the—we are working with the Star Ride Association as we speak. They have put together a very good group of about five large truck company owners and they are working with our people to explore ways that we can move into using natural gas, especially for the long haul fleets. What we have to figure out is how to make that a win-win, and we would like to be able to compensate these companies for making these investments, at the same time share some of the savings.

In fact, we have even reached out to the Department of Energy. We think this would be a good project for some investment, rather than some of the others that have been made, because there are definitely opportunities to get some payback on this.

Senator PRYOR. And do you think you will save money by doing that?

Mr. DONAHOE. We think we will save money and we think the Star Ride Association will save money, and we think it is a good thing for the environment.

Senator PRYOR. And let me ask you, Ms. Goldway, if I can, you mentioned in your testimony that a, quote, sizable portion of the U.S. population still depends on the mail to help manage their lives and communicate with businesses, governments, and social institutions. Would you tell us more about that sizable portion of people and kind of what you mean and how they are going to be affected by some of these changes?

Ms. GOLDWAY. There are many people, especially in rural areas, but, in fact, throughout the country who are not connected to the Internet at all. And while we talk about the dramatic changes that are taking place, as much as a third of the country is either not connected or not connected at a strength of broadband that would enable them to have the kind of interactive products and communications that we talk about.

And yet, our government is committed to providing universal service of communication to everyone. So we need to have a Postal Service that does that. Furthermore, as long as we do not have a national identification system and we rely on where you live to identify you, the Postal Service is the address master for the country.

And the Postal Service really needs to be maintained in order for people to vote, for their children to be enrolled in schools, for all ranges of emergency services. It is a vital network. And when we talk about balancing the needs of the public and businesses, we have to keep that in mind.

And it is difficult. It is not an easy situation when we know, as other Senators have pointed out, that it is more expensive to provide service in the rural communities. But it is something that has to be planned for and has to be watched over. And we believe that some sort of regulatory oversight that assures that protection is necessary in whatever legislation is developed to give the Postal Service the additional financial support that it needs.

Senator PRYOR. Thank you.

Ms. GOLDWAY. Thank you for that opportunity.

Senator PRYOR. Thank you, Mr. Chairman.

Chairman CARPER. Thank you, Senator Pryor. Senator Coburn, anything else you want to say before this panel leaves?

Senator COBURN. I will have some questions for the record.

Chairman CARPER. Before you all leave, again, thanks very much. Excellent testimony, very thoughtful testimony. I thought a real good discussion of some mighty important issues. Mr. Williams, you always bring a lot to the field, like they say in sports, not leaving anything on the playing field. So we have a lot of good ideas out there and I thought this was a hopeful conversation, and I am looking forward to our next panel of witnesses.

I just want to say, we probably do not say this enough and I want to say it. When folks look at the service they get from the Federal Government, in some cases they are pretty happy, in some cases not as happy. We can always do everything better. The Postal Service can do everything better as well.

But we need to keep in mind, of all the services, government-related services—and this is not an entirely purely government operation we know, but folks in this country still have a very high regard for the Postal Service. I think over the last 7 or so years, still No. 1 compared to the rest of the services that we provide. That is pretty good.

We can do better and I want to make sure that we do better, especially when people go into a post office around the country for service, that they get friendly service, they get prompt service and they get friendly service. For me that is important. I know it is for our Chairman, Chairman Goldway. I would just ask that you keep that in mind.

The other thing I want to say to any of the folks around the country who work for the Postal Service or retired from the Postal Service, I just want to say we appreciate your service. We appreciate what you do for all of us. We want to make sure that you and your descendants will be around for a long time to continue to provide that service and we will be around for a long time to enjoy seeing you get better. Thanks so much.

Mr. DONAHOE. Thank you.

Mr. WILLIAMS. Thank you, Mr. Chairman.

Chairman CARPER. With that, I would like our second panel of witnesses to come forward, please. All right, everybody. I would ask you to calm it down. We have this panel. We want to hear them. I would ask you to take your conversations out into the hallway, if you would, please. These folks deserve our respect, they certainly have our thanks.

I will just briefly introduce our witnesses. I want to start off by introducing Cliff Guffey. Cliff, very nice to see you. He serves as President of the American Postal Workers Union (APWU) since 2010. Tough leader, tough negotiator, but also a very fair-minded person who cares deeply about the Postal Service.

I would say the same thing about Jeanette Dwyer. Great to see you. Always welcome the chance to meet with you. President of the National Rural Letter Carriers Association (NRLCA), I think since 2011.

The next witness, Mr. Beeder, Mr. John Beeder serves as President and Chief Operating Officer (COO) of the American Greetings Corporation and has served in various executive roles in the greeting card industry for 30 years, starting as a child, I bet. Welcome, aboard.

And next we have Jerry Cerasale—is that right? It is not right, is it?

Mr. CERASALE. Cerasale.

Chairman CARPER. Cerasale, OK. I am sorry. It is a tough one. Mr. Cerasale has served as Senior Vice President, Government Affairs at Direct Marketing Association since 1995. Mr. Cerasale, great to see you.

And finally, Seth Weisberg. Seth is currently the Chief Legal Officer for Stamps.com, and has worked in various capacities for the company since 1998. Mr. Weisberg, happy to see you all. We are going to ask you to take about 5 minutes to give us your testimony. If you go way beyond that, I will have to rein you in, but if you could stay in that neighborhood that would be great. We will start off with Cliff Guffey. Mr. President, welcome.

TESTIMONY OF CLIFF GUFFEY,[1] PRESIDENT, AMERICAN POSTAL WORKERS UNION

Mr. GUFFEY. Thank you, sir. Dr. Coburn.

Senator COBURN. Welcome, being a fellow Oklahoman.

[1] The prepared statement of Mr. Guffey appears in the Appendix on page 93.

Mr. GUFFEY. Good morning, Chairman Carper and Members of the Committee, thank you for this opportunity to testify on behalf of the APWU about maintaining postal services, reducing costs, and increasing revenue. No discussion of reducing postal service costs can occur without a discussion of the requirement of pre-funding of retiree health benefits.

As I have said elsewhere, S. 1486, as it stands now, is fatally flawed and we oppose it as written. It fails to correct what was the cause of the Postal Service's financial crisis, the mandate in the Postal Accountability and Enhancement Act of 2006, that the Postal Service pre-fund retiree health benefits.

Because of that requirement, there has been a lot of ill-considered and destructive cost-cutting by the Postal Service. These sorts of cost-cutting efforts must be stopped. They are penalizing the workers, men and women, of the United States Postal Service by threatening their jobs and undermining their benefits.

They are cutting services to the American people and instead of protecting Postal Service from impending financial disaster, they are dismantling our Nation's postal services. To our utter dismay, S. 1486, as written, would permit cost-cutting from health benefits and retirement benefits. It would remove the cornerstone of the 1970 law that created the Postal Service by making it possible for the Postal Service to attack our retirement and health benefits.

Those benefits are part of the Federal law that created the Postal Service. By permitting the Postal Service to cut costs by attacking those benefits, Congress would be undermining the ability of postal workers to live in security and dignity, both as active workers and after they retire.

We vehemently oppose any changes that would interfere with the right of the postal employees and retirees to continue to participate in the Federal Employees Health Benefits Program (FEHBP) and Federal retirement programs. While the Postal Service claims that it can lower health care costs, that is not true. What the Postal Service seeks to do is shift costs from itself to employees, to retirees and Medicare. This is not acceptable.

It is a desperate and ill-considered attempt to deal indirectly with what should be dealt with directly, the retiree health benefits pre-funding requirement. Because of the pre-funding requirement, the Postal Service has cut costs in ways that have created hardships for postal workers and threatened to destroy the Postal Service. The Postal Service has closed mail processing facilities, closed post offices, lowered its service standards, and reduced hours at post offices, particularly in rural and small communities.

The Postal Service has cut its mail processing network so deeply and so recklessly that it is now violating standards mandated by law, standards that the Senate sought to protect when it approved S. 1789 last year. Network consolidation is delaying first-class mail and periodicals by 2 or 3 days in many places. We urge this Committee, the Senate, and the Congress to insist that the service standards be maintained.

Likewise, retail services and services to rural areas have been cut and are still at risk. Retail services and rural post offices must be preserved and protected. In addition, it is past time for the Federal Government to stop holding onto excess Postal Service funds that have been deposited in Federal retirement programs.

Postal rate payers have, for many years, been subsidizing the Federal Government through substantial overpayments into Federal accounts. This has always been unfair to the rate payers, but now it is more than unfair. It is unsustainable. To correct this, postal retirement obligations must be recalculated on the basis of postal employee demographics and all over-funding in Federal retirement accounts must be repaid to the Postal Service without restriction.

We think Title V of S. 1486, which would cut benefits for injured employees throughout the Federal Government, is an example of how postal cost-cutting threatens to penalize postal employees. It is wrong, we oppose it, and it should be removed from this bill and dealt with elsewhere.

As the Chairman and this Committee have recognized, it is necessary to repeal the restriction on the Postal Service providing nonpostal services. There are many ways in which the Postal Service can use its mail processing, retail, transportation, and digital networks to provide useful and new services that will enhance the Postal Service's performance, aid our communities and small businesses, and to help sustain the Postal Service.

We appreciate the fact that Chairman Carper and Ranking Member Dr. Coburn have addressed the issue of postal revenues and a CPI cap on rates. We believe the CPI cap is unsustainable. To preserve universal service, a better balance must be found between rates and service. APWU members have borne the brunt of the drastic changes made by the Postal Service in the past 7 years.

Our members have been penalized unfairly for financial problems they did not create and could not control. The APWU cannot accept efforts to impose further sacrifice on postal employees. Thank you and I am available for questions.

Chairman CARPER. Mr. Guffey, thank you for your testimony very much. We look forward to asking some questions. Ms. Dwyer, welcome, nice to see you.

TESTIMONY OF JEANETTE P. DWYER,[1] PRESIDENT, NATIONAL RURAL LETTER CARRIERS' ASSOCIATION

Ms. DWYER. Good morning, Chairman Carper and Members of the Committee. I appreciate this opportunity to testify on behalf of the NRLCA. The NRLCA and its members care deeply for the Postal Service and the service that it provides to Americans. But we have significant concerns about the damage that the pending Senate Postal Reform legislation will do to that service.

We have shared these concerns in our written testimony, but I would like to use my time today to focus on service. Make no mistake. If the Postal Service is to remain viable and competitive, we need to keep the "service" in Postal Service. This means continuing to utilize its trained and dedicated Federal workforce to provide 6-day mail delivery, keeping sufficient post offices and processing facilities open, and maintaining current service standards.

[1] The prepared statement of Ms. Dwyer appears in the Appendix on page 130.

The Postal Service must also continue to take advantage of and strengthen its unique ability to perform services such as delivering the "last mile". Although the Postal Service is undoubtedly faced with financial challenges, these issues are not primarily the result of its business practices. It is no secret that the most significant restraint on its success remains the congressionally mandated pre-funding of retiree health benefits.

The Postal Service would have shown a $660 million profit in the third quarter of fiscal year 2013 had the retiree health benefits pre-funding burden been excluded. Thus far in 2013, it would have made a $330 million profit excluding the pre-funding payment. This is a remarkable achievement considering the Nation's sluggish recovery from the largest economic downturn since the Great Depression.

It demonstrates the Postal Service's ability to turn a profit while building upon its current business model and continuing to provide universal service. But S. 1486 would disrupt this success. It would slash service, cut delivery days, close post offices and postal facilities, disrupt collective bargaining, and reduce employee benefits, all because of a pre-funding schedule that represents roughly 80 percent of the Postal Service's total losses over the past 6 years.

These changes will drive more and more people away from using what is consistently ranked the most trusted government agency, and will eventually lead to the Postal Service's demise. We have already seen the negative impact of these cuts and reductions. Prior service changes and plant consolidations have slowed down processing and delivery times across the country.

Numerous accounts are coming in from rural letter carriers that mail is coming to them late in the day. This means late delivery to customers, often after dark, inconveniencing customers awaiting parcels, medications, and other important items.

Meanwhile, mail that carriers collect on the route is often sitting overnight before being processed because many post offices have imposed earlier dispatch times, meaning that mail collected on the route does not come back in time to be sent to the plant.

Shipping and package delivery revenue continues to increase dramatically as a result of a rapidly increasing e-commerce sector, which is helping to mitigate the negative impact of online communication and bill pay. But further cuts will continue to chip away at the Postal Service's ability to efficiently handle the mail and package volume coming through this system.

The NRLCA strongly believes that S. 1486 would cause the Postal Service to abandon those Americans who most depend upon the regular delivery of the mail. Rural America, in particular will suffer extreme hardship if our customers and small businesses lose a day to send and receive mail.

The livelihoods, and often health and well-being of entire communities depend on the Postal Service to facilitate communication and deliver goods. In many parts of rural America, there are simply no alternatives. In the past, the Postal Service and its rural letter carriers have always been there for them. I am here today because I want rural carriers to continue to be able to provide high quality service to their customers.

Mr. Chairman and Members of the Committee, we have the potential to succeed if only Congress would address the unfair prefunding mandate and allow the Postal Service to focus on growing the business, not shrinking it by reducing delivery service. By doing so, you will give the Postal Service a fighting chance to remain viable without taking drastic measures that will only harm this great institution. The Americans who rely upon it, and the employees, such as rural letter carriers, who serve it with determination, integrity, and pride.

Thank you for allowing me to submit testimony and I would be happy to answer any questions.

Chairman CARPER. Great. Madam President, thank you so much. Thanks for the testimony and for being here with us today. Mr. Beeder, great to see you. Please proceed.

TESTIMONY OF JOHN BEEDER,[1] PRESIDENT AND CHIEF OPERATING OFFICER, AMERICAN GREETINGS

Mr. BEEDER. Thank you, Senator Carper, Senator Coburn. I am speaking here today on behalf of the Greeting Card Association (GCA), which represents more than 150 publishers of greeting cards and related social stationery products throughout the United States. We are grateful for the opportunity to participate in today's hearing.

S. 1486 contains many desirable reforms and initiatives. We are pleased to see the two common sense recommendations. A shift to more cost-effective modes of delivery and a realistic treatment of retiree health benefit funding are prominent features of S. 1486.

However, the ratemaking provision of S. 1486 is a matter of grave concern. Section 301 should be stricken and the current PAEA ratemaking provisions left in place. The Postal Service's financial problems are not due to the ratemaking system. The Postal Service today has a cost problem, not a ratemaking or a revenue problem.

The unworkable PAEA retiree health care pre-funding schedule, appropriately redesigned as in Section 103 of the bill, cures a large part of the Service's current deficit. Thus, there is no reason to encourage it to drive away customers and reduce its own revenue by eviscerating the ratemaking system as S. 1486 would do.

Doing away with PAEA's relatively liberal price cap incentive to efficiency after 2016 makes no sense, especially in the context of other important features of S. 1486. With neither a close tie between rates and costs nor an exogenous price cap limiting increases there would be nothing in the statute to forestall resorting to regular rate hikes above the CPI as a way of avoiding the unavoidable.

S. 1486 would weaken existing controls unnecessarily. Today there is an independent evaluation by the PRC of whether each new set of rates conforms to the price cap. Handing this function over to the same Board of Governors, which directed the filing of the rates in the first place, would put the Board in the untenable position of independently verifying its own actions.

[1] The prepared statement of Mr. Beeder appears in the Appendix on page 136.

Another serious flaw in the bill is treatment of exigency rate cases where at least four legal standards must be met. These have the potential to be controversial. The evaluator must find, one, that exceptional or extraordinary circumstances are present; and then that the increase is, two, reasonable; three, equitable; and four, necessary under the best practices of honest, efficient, and economical management.

S. 1486 would have the Board of Governors decide these four difficult questions. This is a conflict of functions and would allow the Postal Service to effectively act as an unregulated monopolist. These problems cannot be solved by allowing rate decisions to be reviewed by the PRC on complaint. Injured mailers, who have the burden of proof, would be hard-pressed to meet the considerable expense of proving such a case. The Board of Governors would decide rate questions with apparently no obligation to describe or disclose all the data and assumptions upon which they relied.

Moreover, during the complaint process, the complainants would be paying questionable and, perhaps, provably unjustified rates. We could realistically expect potential complainants would simply switch more of their communication to alternative carriers or to the electronic media.

Another ill-advised feature of the bill is Section 206 which does away with the PRC's advisory opinion role in connection with significant nationwide service changes. First, abolishing any independent, pre-implementation review would be a serious loss of users of the mail and the Congress itself.

The PRC's advisory opinions have provided a well-informed, objective view of these changes, some of which are fundamental definitions of the level and quality of service that should be of concern to Congress. Section 206 appears to contemplate rate and classification changes along with or as part of a service change. This could make estimation of the combined effects almost unmanageable.

The GCA is also disappointed that S. 1486 seriously weakens the sensible compromise reached in the 112th Congress on reducing delivery days. Section 207 of S. 1789 appropriately required a 2-year waiting period and a determination, subject to review by the Government Accountability Office (GAO) and the PRC, that other prescribed cost-savings measures did not obviate the need to cut service in order to achieve long-term solvency. These necessary safeguards are diluted or omitted altogether in S. 1486.

To summarize, Sections 301 and 206 should be stricken from the bill to restore the bill's focus on creating a streamlined, cost efficient, capable Postal Service to meet today's needs. Encouraging an approach to financial problems that would facilitate potentially large rate increases and service cuts, cuts needlessly and undermines the beneficial features of the bill. And eliminating independent review of important decisions is not in the interest of mail users, the Congress, or in the long run, the Postal Service itself. Thank you.

Chairman CARPER. Mr. Beeder, thank you so much. Mr. Cerasale, please proceed.

TESTIMONY OF JERRY CERASALE,[1] SENIOR VICE PRESIDENT, GOVERNMENT AFFAIRS, DIRECT MARKETING ASSOCIATION, INC.

Mr. CERASALE. Thank you very much. Good afternoon, Senator Carper, Senator Coburn, it is a pleasure to be here and I am here representing a united mailing industry, including the Affordable Mail Alliance, the Coalition for a 21st Century Postal Service, all major customer trade associations, paper, printing, and mailing technology industries. Together it is a $1.3 trillion industry that employs nearly eight million private sector workers and constitutes some 9 percent of gross domestic product (GDP).

It is those businesses, non-profits, and other mailers whose decisions to purchase postage pays the bills of the Postal Service. They account for approximately 80 percent of mail volume and contribute 90 percent of the revenue of the Postal Service. Yet, that industry has lost since 2007 over one million jobs and many more are still at stake.

So we are very pleased to be invited here today to testify before you. We are encouraged that you remain invested in postal reform. We appreciate your leadership on this vital matter. My written testimony contains our positions, and often our support, on many of the provisions in your bill, S. 1486, and I ask that the testimony be admitted in the record.

This afternoon, I do want to focus on one major area, postal rates. S. 1486 would grant the Board of Governors of the Postal Service unilateral pricing authority for the mail over which it has both the statutory monopoly for delivery and a monopoly over the mail receptacle. There would be no price cap and there would be a weakened Regulatory Commission that would have after-the-fact complaint review with no authority to set postage rates and no authority to require refunds. What monopolist would not want such power?

And although the monopoly is weaker than it has been, it still exists, and even if it were eliminated, the Postal Service would still maintain market power over the delivery of paper letters. We oppose that expansion of monopoly power. We do not think it is good for the economy, for our industry consistent with our system of checks and balances, and in the long run, we do not think it is good for the United States Postal Service.

Elimination of the price cap, a cap which the PRC today said has been successful in reining in costs of the Postal Service, would reintroduce uncertainty and unpredictability in rate setting and drive out mail from the mail system at a faster pace. We hear that all the time from executives of our companies.

We also have heard today that mail volume is price inelastic. Any mail volume lost would be more than compensated by an increase in postage revenue. We disagree with that, particularly when postage increases are more than the rate of inflation. Inspector General Williams has said that his price elasticity study was limited to small changes in price, not inflation busting increases.

The last time market dominant postage rates were greater than the rate of inflation was May 2007. I am going to use the example

[1] The prepared statement of Mr. Cerasale appears in the Appendix on page 201.

of catalogs. Catalogs received a double digit postage increase in May 2007 and in the next year, volume for those catalogs dropped 23 percent. And most of that volume was the loss of prospecting mail, looking for new customers, and the investment which is the investment in the mail future.

During that time of 23 percent volume drop, standard mail increased—volume rose. However, if catalogs were inelastic, even with a 23 percent volume collapse, postal revenues should have increased. It did not. Revenue dropped 11 percent. The catalogs were not price inelastic.

Now, the Postal Service has relied on similar studies when it invested in flat shape sorting equipment to bring down the cost of sorting mail, which we agree with. Unfortunately, the 23 percent drop in mail volume resulted in too little flat-shaped mail to make running those machines efficient.

We are paying for that mistake. The mistake is one of the primary reasons the flat-shaped mail is currently, quote, underwater, close quote. We urge you not to make decisions based upon studies that do not apply, or we think do not apply, to inflation—above inflation postage increases. Please do not eliminate the cap.

We ask you also to include the compromise in the Postal Reform bill that the Senate passed last Congress to study the effects of excess capacity on flat-shaped mailing costs before requiring any postage changes. Many of the provisions of S. 1486 will alleviate the financial pressure on the Postal Service. Allow those to work before enabling above-CPI postage increases.

Mail is not price inelastic with above-inflation postage increases, and the Postal Service will suffer in the long run. We pledge to work with you to find solutions in the Postal Service financial status that do not drive customers away from the mail. Thank you very much for the time and I look forward to your questions.

Chairman CARPER. You bet. Thanks, Mr. Cerasale. Mr. Weisberg.

TESTIMONY OF SETH WEISBERG,[1] CHIEF LEGAL OFFICER, STAMPS.COM

Mr. WEISBERG. Thank you very much for inviting me to speak today. I am here on behalf of Stamps.com, the leading PC postage company. PC postage is Internet-based computer software that allows customers to print their own postage using their existing computer and printer. Our software has been developed to provide a full suite of modern, cutting edge tools to mailers and shippers. We provide continuous product improvements and high touch customer support all at negligible cost to the Postal Service.

Customer adoption of PC postage has grown rapidly since it was introduced and has brought in new mail volume that would otherwise have gone to postal competitors. Just 6 years ago, PC postage accounted for roughly $250 million in annual postage sales. In 2012, Stamps.com, and Endicia together, accounted for over $2.85 billion in postage sold.

Stamps.com postage growth alone was more than 70 percent year over year in 2012. That is right, growth even through the heart of the recession. The substantial majority of postage purchased

[1] The prepared statement of Mr. Weisberg appears in the Appendix on page 211.

through PC postage is used on Priority Mail and Express Mail products, the classes of mail that provide USPS with its highest level of contribution above direct costs.

Virtually all the Priority and Express growth surge in recent years is generated through the PC postage industry channel. A recent Postal Service study showed revenue through the PC postage channel costs two cents per $1 of revenue, compared to 47 cents per $1 of revenue through a USPS-owned retail outlet.

Our technology includes batch capability that allows users to print a large volume of shipping labels all at once, database integration technology for seamless, automatic import and export of information to and from a customer's internal order database, and direct integration with e-commerce platforms.

An e-commerce merchant with multiple stores can consolidate all of their orders so they can ship them out with ease. With one click, they can directly import all of their order data from the most popular online marketplaces, including eBay, Amazon.com, Yahoo!, PayPal, Google Checkout, and Etsy, plus the most popular shopping cart software. When they are ready to ship, they can just select the orders and print their shipping labels.

All the shipping data, including USPS tracking, will automatically post back to their web stores. They can also automatically order a carrier pick-up, send an electronic manifest to the Postal Service, and generate a scan form so all the carrier has to do is scan the form once and all of the packages are automatically in the Postal Service's computer systems.

We believe that public/private partnerships are the best path forward for the Postal Service as technology innovation becomes increasingly important for its future. The Postal Service's e-commerce shipping business has been on fire because of a deeply successful public/private partnership set up over a decade ago.

The existence of the PC postage industry is based on a partnership between the Postal Service and private industry that was forged in 1995 when the Postal Service intelligently decided that the extremely challenging technology issues that need to be solved to allow a standard PC to print U.S. legal tender in a secure and convenient method were best solved by private industry.

Public/private partnership in the PC postage industry takes the form of the Postal Service regulating industry participants to make sure they are secure and work well technically with the Postal Service's systems. The Postal Service also partners with the industry to achieve mutual win-win goals of improving the customer experience, increasing revenue, and minimizing costs.

Pat Donahoe and so many of the dedicated postal veterans who have ably worked with us for many years deserve much credit for the success story that is the partnership between the Postal Service and the PC postage industry. Thank you.

Chairman CARPER. Dr. Coburn has another engagement he needs to get to. I am just going to say one quick thing and then I will just turn over the questioning to him and then I will wrap it up. Mr. Cerasale, in your comments, you mentioned the rate hike, I think you said it was April 2007, and then we saw like a year later the drop of, I think you said, 23 percent in mail volume for at least one particular product.

My recollection was the worst recession since the Great Depression actually began in 2007 and we sort of hit the bottom, like at the bottom of the cliff, sometime in late 2008. So I just would have us keep that in mind. You do not have to say anything. Now let me yield to Dr. Coburn. We will continue that conversation. Thank you. Senator Coburn.

Senator COBURN. I want to ask Mr. Cerasale, you said your industry represents 9 percent of the GDP in this country? That was your testimony?

Mr. CERASALE. $1.3 trillion worth of—yes, it is about 9 percent of the GDP.

Senator COBURN. Well, that is not just your industry. That is the side effects coming off of your industry.

Mr. CERASALE. Yes. The entire mail community industry.

Senator COBURN. The entire mail community industry represents $1.3 trillion?

Mr. CERASALE. Yes.

Senator COBURN. I would like very much for you to supply the back-up of that data to this Committee.

Mr. CERASALE. I will.

Senator COBURN. That means it is the second largest component of our whole economy.

Mr. CERASALE. I will do that, yes, Senator.

Senator COBURN. I doubt seriously that is factual. We have had some criticism, Mr. Cerasale, on the IG's study, and in your statement, you say it is unacceptable to give more pricing authority to the Board. But that would tend to contradict your position in PRC Order 154–1, which I will put your letter[1] to the Postal Regulatory Commission in the record.

Chairman CARPER. Without objection.

Senator COBURN. Where it says, you do not believe the Commission has the authority to require further adjustment in this proceeding. So my question is this, do you trust the PRC more than the Postal Service when it comes to pricing standard flats?

Mr. CERASALE. The Postal Service has a monopoly and there needs to be someone to overlook it.

Senator COBURN. So here is my question to you on that. Do you think that a Board of Governors of the Post Office is going to give a price that is going to cause them a 23 percent loss in volume in the first year of a recession?

Mr. CERASALE. Well, it was the first year of the recession, but standard mail rose during that year.

Senator COBURN. I understand that. I mean, it is prudent. Any of your businesses that you represent, are they going to do that? They are not going to do that.

Mr. CERASALE. My businesses would not do that with a product that they could not sell with volume dropping. They would most likely reduce prices to try and increase sales and volume and not raise prices whatsoever.

Senator COBURN. And so right now, your industry, in terms of the Post Office, what is the net difference in revenues versus cost of delivery of your products today?

[1] The letter to the Postal Regulatory Commission appears in the Appendix on page 233.

Mr. CERASALE. Well, if you look at the——

Senator COBURN. Today. I mean, this last year.

Mr. CERASALE. Yes, I understand. The Postal Service has lost, I think it is a $6 billion loss, so I think if you look at—and my industry produces—pays for all the mail, that is it. Part of that cost, of course, is the retiree health benefit pre-funded. They are——

Senator COBURN. I am actually trying to get to your industry and what the revenue is the Postal Service gets off of your industry versus what it costs to deliver your mail.

Mr. CERASALE. Right.

Senator COBURN. And I think that number is in excess of $500 million last year, was the difference between the cost of delivering your product and the revenue that came from that, and I would be happy to share that with you.

Mr. CERASALE. Sure. I was trying to answer in terms of all the mail, which is what—we produce 90 percent of the revenue, 80 percent of the volume. So it virtually looks at the—you would have to say that in large part, it is the financial bottom line of the Postal Service. That is the differential.

Senator COBURN. All the more reason——

Mr. CERASALE. That is 90 percent of the volume and that includes—that cost includes what the Postal Service will be defaulting.

Senator COBURN. All the more reason. If you are that integral of a part of the revenue of the Postal Service, would not cogent members of the Board be very slow to cause something that would lose them significant volume?

Mr. CERASALE. They should be.

Senator COBURN. Well, do you think they would not be?

Mr. CERASALE. Our businesses, people that we talk to in our industry, would try to look to lower prices to get more volume. That is what they would do if there is a volume—a sales problem. And that is not what the Board of Governors is looking to do.

Senator COBURN. Well, but what they are—I guess the point I am trying to make is, right now, the cost to have your business is a half-a-billion dollar loss——

Mr. CERASALE. OK.

Senator COBURN [continuing]. In the Post Office. So the question is, are there not smart people that can say, where is the best cost benefit ratio for the Post Office in terms of your industry? And are you saying you do not think those people are available to make those decisions?

Mr. CERASALE. I think there are people available to make that decision, but I would not put it in the hands of the monopolists totally. As I said in my written and in the oral statements, we have an excess capacity issue that the Postal Service based on numbers that have been produced and purchased the flat sorting equipment system that is not utilized because the volume went away. The volume went away on a pricing decision.

So we think that eliminating that kind of excess capacity—and the Postal Service has done an excellent job eliminating capacity, but we have seen drops in first-class mail volume long before 2007, and some of those changes should have been occurring sooner.

Senator COBURN. But if you look at their employment, they had a shrinkage of 100,000 employees before the caps were ever put in.

Mr. CERASALE. Yes.

Senator COBURN. So they recognized that problem. It was not that they did not recognize it. Let me move on, I think, if I can. In your statement, you say in today's competitive world, the market will be determinative regarding postage rates. That is exactly what our bill is trying to do, is let the market be determinative.

And I understand. If I was sitting where you are, I would say, no, I want a second shot at this every time. And I do not disagree. I am a private sector guy. I understand that. But there has to be a balance. We cannot continue to subsidize the flat business at a half billion dollars a year and then tell the people who are working for the Post Office, oh, by the way.

And so, the question is, is there is a balance there? There has to be a balance. And what Senator Carper and I are trying to do is to create the environment where all those factors are taken into consideration as you make those decisions. And the way the Postal Regulatory Commission is set up is, you are going to second-guess it a lot. And then if you do not agree, you can sue them.

So we are trying to change that to where market forces really are determinative. And it may just be that they lower the price so flats will come back based on what their market analysis says.

Mr. CERASALE. I am not here just representing flats. I used the catalogs only as an example. I am representing all shapes and sizes and so forth.

Senator COBURN. I understand that.

Mr. CERASALE. But we agree that market forces should help determine what prices are asked, but you do have a statutory monopoly and it is there, it exists, and it is a monopoly not just on the delivery of letter mail, but a monopoly on the mail receptacle as well. That also has some significant market power that the Board of Governors would have control over in setting rates, and that is the problem that we face.

And I do not have an exact solution for it. I know that eliminating the cap, after-the-fact review, no refunds, and think about it. How would we even do refunds?

Senator COBURN. Well, we have already testified. There are ways to do refunds on the large customers. There is no question about that. Let me make one other point with you. We are going to have a postal system and what we know is we have to make it viable. We have to make the numbers work. And we cannot do all of that on the backs of the people who work for the postal system. It cannot happen.

But here is what is going to happen if we do not get this right and we do not use market forces. You are not going to use the Postal Service.

Mr. CERASALE. That is right.

Senator COBURN. You are going to go and build warehouses and packaging where you are putting all the catalogs and mailers in a parcel box and then you are going to come back and use the Postal Service. So you are going to get your product out there, whatever the market determinative way says.

And what Senator Carper and I are trying to do is balance both the pricing and the cost and give the flexibility so that the decisions can be made in real time, because it is acute. They are at their limit on borrowing. We are going to try to make all the changes that we can in terms of pre-paid health care. We are trying to make the changes in terms of the retirement funds that have been put in excess. We are trying to do all those things.

But to say that we are always going to have a slow process when, in fact, market ought to determine—just as your testimony said—what the price ought to be that you are paying. And they are not going to do something that is going to kill their volume because that is what they need right now. They need volume and revenue.

And so, I understand where you are coming from representing your industry and I appreciate it, but it is like I have told everybody in your industry, there is going to be more than an inflation cost because we cannot even meet the commitments that we have now to the postal employees unless there is something.

Now, how much that will be versus how much volume loss that is, they are never going to make a decision that gives them less revenue. They are going to make a decision that gives them more revenue, and that volume/price relationship is going to be determinative in the marketplace. And so, you have an extra Governor out there for you because they need you, they want you, and they are not going to run the prices up on you excessively. I am out of time. I will let you go and then I will come back.

Chairman CARPER. Mr. Cerasale, are you ready for a break?

Mr. CERASALE. No.

Chairman CARPER. Pick on somebody else here for a minute or two?

Mr. CERASALE. It is a good discussion.

Chairman CARPER. Real good discussion.

Mr. CERASALE. It is one we should have. This is an important question.

Chairman CARPER. Back when we introduced this bill, what we hoped to do was to foster a good discussion and we certainly have, and this is continuing. I guess it is going to continue next week and well beyond. But this has been a real helpful hearing to us thus far.

I have a couple of questions. I am going to ask each of you to take maybe less than a minute and just give us a closing thought, so you will be thinking about what you want to leave us with. Then we are going to wrap it up and head for the hills.

I want to come to, if I could, to Mr. Weisberg. I held up earlier this mailer that I got, Mr. Weisberg. I do not know if you were here when we did it, about sort of the re-branding of Express Mail. They call it Priority Mail Express. I have a really smart new product and one that I think is actually going to make a lot of money for the Postal Service. We will see if that is true.

But you said earlier you cannot just cut, cut, cut, although there are a lot of ways to save money. The Postal Service has identified those. They have worked with their unions, their employees, the Board to do that. But we talked a little bit, briefly, about what we need to do to reduce the Federal budget deficit further. We are down from $1.4 trillion to $700 billion. What do we need to do further? I have said we need entitlement reform that saves money, saves programs, does not savage old people or poor people. That is No. 1.

No. 2, we need tax reform to actually generate some revenues. And we need to figure out how to get a better result for less money in everything we do. It is interesting to me how many people have said to me over the last 4 or 5 months, they are willing to pay a little more in taxes. They just do not want us to waste their money. That is what they say. They say, I am willing to pay some more taxes. I just do not want you to waste the money.

So for us on the Postal side, that means we have to look at the cost side and where we can take costs out, what do we need to do in our jobs, here in Congress, to enable those savings to be realized. And obviously, the unions have to be a part of this, in the give and take process with management.

But even after we have done a fair amount on the cost side, there is some more to be done. A big discussion on health care, very important discussion next week on health care, as you know. I just want to come back to you. I appreciate very much your insights.

But you talked about how public/private partnerships are the best path forward for the Postal Service, I think you said, the success of PC postage, which certainly supports your point. How can the Postal Service help create a more nurturing environment for the marketplace to create new products that help its customers? That is No. 1.

And second, we know you are not a futurist. Neither are we. But could you offer any insights on what untapped innovation opportunities might be out there for the Postal Service? And you referred to a couple of those. The Postmaster General gave us a pretty good list.

Our friend, the Inspector General, gave us a pretty good list. But just anything that you heard out there, anything of your own. What are some other untapped innovation opportunities that you are aware of that you would certainly underline, highlight, say for God's sake, do these? Please.

Mr. WEISBERG. Thank you very much. For your first part of the question on how to foster public/private partnerships in the development of technology, I would really point to working well with your partners, doing deals with them in a fair and square way, and for us, we would also say not unfairly competing with your own business partners.

So it is really a focus on working together well, putting good incentives in place, and then getting out of the way to let it be done efficiently and well. And the Postal Service has worked for us very well in that way, I would say. One suggestion I would have for the Postal Reform bill in that area is some language that you will see in the House bill that talks about making sure the Postal Service is not unfairly competing with postage evidencing providers.

In the second part of your question, where are the real revenue opportunities for growth through innovation, and it is in packages. You have been hearing about it. The Postal Service has a huge role in packages. They have a tremendous cost advantage by going to all of the consumer locations. There is huge growth coming in the delivery of packages, and the Postal Service is getting the smallest share of it amongst its competitors today.

By having cutting edge technology, that means product developments, updates that happen on a daily basis, that means having 24–7 high quality, high touch customer support, all of the modern things that a technology company can do, the Postal Service has a tremendous opportunity to continue to grow the package business in a big way for many years to come. So it is really innovations around that.

And if you look at what has been set up with the PC postage industry, our salespeople can go working hand-in-hand with the Postal Service sales force to a company that needs to get up and running shipping packages, even a large company, and have them shipping overnight.

We had one example where a major health care provider, Kaiser in Southern California, had a sudden need, because of DHL being shut down, to get drug prescriptions really quickly to its customers. They came to us at 5 p.m. one day. The next day they were printing out all of the Express Mail shipping labels to do it.

In order to do that, you really need a private technology company that lives and breathes—we are based in California—the way that those companies work to be able to get customers up and running quickly and to do it in an efficient way. All of that without the Postal Service paying money for it. For the Postal Service to try to do that itself would just be so much less efficient.

Senator COBURN. I just had a few questions for Mr. Beeder. I am a big buyer of cards. When I go in a place, I buy them.

Mr. BEEDER. Thank you very much.

Senator COBURN. You talk about inflation, though, over the last 10 years. I just have some examples. It is your birthday. That is a $3.69 card.

Mr. BEEDER. And worth every penny of it.

Senator COBURN. Well, it depends.

Mr. BEEDER. OK.

Senator COBURN. I am going to make a point here.

Mr. BEEDER. OK. I know you are.

Senator COBURN. Here is a card that is $3.99. This was made by your competitor. Here is a cheap one. It is only 99 cents. So let us just take—oh, and this one is a Superman for Senator Carper, $5.99. So let us just take, for example—I do not know what the average is, but let us say $2. And a postage stamp right now is what?

Mr. BEEDER. Forty-six cents.

Senator COBURN. Forty-six cents. And inflation last year was what?

Mr. BEEDER. What was it, Senator, 3 percent?

Senator COBURN. Less than 2 percent.

Mr. BEEDER. OK.

Senator COBURN. All right. So 2 percent on 46 cents is a penny. Now, let us say if the average cost is $2 and you went up inflation, that is 4/10ths of 1 percent. If you went up twice inflation, that is about 6/10ths of 1 percent. So you went up twice inflation. Do you think that the demand price curve on your card, which is—I think $2 is way too cheap for the average card in terms of my assessment.

Do you think that actually makes a difference? Instead of the one penny increase or two penny increase, do you think that actually makes a difference when I am buying a $5.99 or $4.99 card, especially when it is all around holidays? Explain to me your concern about a 4 percent postage increase for the mailing—in your section of the mailing industry and how that works economically, because I really do not understand it.

Mr. BEEDER. Well, you mentioned holidays. A good number of the cards sent through the Postal Service are actually holiday cards. And when you buy a holiday card or an invitation or even a piece of stationary and you want to mail it, you will buy frequently a holiday card, 20 of them in a box for $6 or $8.

So the cost of that card would be 30 or 40 cents, not $2. I wish every card we sold was $2.

Senator COBURN. Almost every one I buy is way more expensive than that.

Mr. BEEDER. Can I have your name and number? We will get you some marketing materials.

We are concerned because the holiday volume is so strong that the postage stamp actually costs more than the greeting card. So that when you increase the prices on postage, you fundamentally change the economic equation of a consumer who might be sending 60, 80, 100 cards on the holiday and they have to fund all of that postage. That is where it really hits home in our industry.

Regarding the pricing of those greeting cards, one of the things that we have worked very hard on, that you have encouraged the Postal Service to work on, is innovation. So we have competition from the Internet, we have competition from all of these online sources, so we have improved the capability of what greeting cards can do so that we can compete with those services. Greeting cards walk, they talk, they bounce, they jiggle, they have Superman on them and——

Senator COBURN. They sing songs.

Mr. BEEDER. That is what we have to do. But we do not live in a monopoly environment. We have to compete in the marketplace against all types of things and if we do not deliver innovation and keep track of prices, make sure that we support the Postal Service as we can, it impacts our business a lot.

Senator COBURN. So why would not somebody who is going to send 50 greeting cards this Christmas buy a Forever stamp?

Mr. BEEDER. They could do that this year. But in future years, as the pricing goes up, the price of the Forever stamp will go up, too. That is a solution that might bridge them over for a year or two. We are thinking about the long term, Senator.

Senator COBURN. OK. Thank you very much.

Chairman CARPER. Every week at this time there is a Bible study group that meets over by the Capitol and one of the things that Barry Black always tells us—he is our chaplain, a Navy Admiral, Chief of Chaplains for the Navy and Marine Corps. He always implores the Senators usually the ones that show up are the ones, those of us who need the most help.

But one of the things he always urges us to do is to pray for wisdom. So that is something that a lot of my colleagues and I do. We need to, God knows. I am not going to ask what your prayers are for us, but in terms of imparting some wisdom, this is a chance to give us just a quick closing statement. I will ask you to use less than a minute if you will. I am going to start, Mr. Guffey, with you, Mr. President. Just something you really want us to take to heart as we walk out of here.

Mr. GUFFEY. Just two things real quickly. This is for the Senator from Montana who is no longer here. What people have to understand, these offices where they close a plant down, there are a lot of towns around those plants. And mail would get picked up there at five in the evening, taken over to this plant, and be worked and returned back, 1-day service.

Now since they do not work the mail in Plant A, the mail in these small towns has to leave those towns to get over here to Plant B to be worked earlier in the day, say like at one o'clock. That means all the cards that are picked up, or people want to mail invitations for their kid's birthday party, or sympathy cards for a funeral that week or something, they drop it in the mail and the carrier comes by and picks that mail up.

Then they take it back to the office. Well, the dispatch time has already gone by. So if this is Friday evening, it does not get over to Plant A until Saturday and over to Plant B until the following Monday and that is when those cards are canceled.

So those 3 days do not even count in the Postal Service's system. When they cancel it, then it gets marked into the Postal system and it goes through and their records show 1-day delivery, 2-day delivery, when they have actually added maybe 2, 3, or 4 days on there that do not even count. That is one thing and I have heard two other——

Chairman CARPER. I am going to ask you, I said 1 minute and you are up to 2 minute. One more thing and that is it.

Mr. GUFFEY. OK. That is it. The issue about privatization. Let us talk about privatization. Just two things about that. All these small countries over there like England and what have you, have a great transportation system, do not require movement of mail by airlines. And they also have socialized medicine which means they do not have any current costs for their employees in health insurance and they do not have any future retiree costs.

Chairman CARPER. That is not true for all of them, but go ahead.

Mr. GUFFEY. Well, it is for England and Germany, sir. And to say that is just to say this. They have more expensive—.6 pounds is $1 over here; Germany, it is 78 cents. It is more expensive and they have it privatized and they have it outside. And they do not have discounts. They do not have discounts for big mailers.

Now, we have a system over here that works, it is better for everything, so privatization is not a situation, I think, that works in this country.

Chairman CARPER. OK. Thanks so much. Ms. Dwyer, please be brief, if you will. Get right to the point.

Ms. DWYER. All right. I will try. The rural letter carriers have always been service oriented. That is what I talked about today. We are passionate about it. We believe it. And I am here to tell you, if you try to cut it to 5 days a week, you will destroy the Postal Service.

Chairman CARPER. OK.

Ms. DWYER. We have a firm belief that is true. Listen to the numbers that I gave you today. The Postal Service can succeed. Allow us to do that. Unshackle us from the pre-payment. Do that and give us a chance to be viable, keep us in an environment where we can succeed and we will do that.

Chairman CARPER. All right. Thanks. That was great. The legislation that Dr. Coburn and I have introduced says, essentially, a year after enactment of the bill, the Postal Service may go from 6 to 5-day per week services. You still have to have post offices open, access to postal boxes, they still have to do parcel and package delivery, and they are free to provide the service even on Sunday if they can find a way to make that financially viable.

But if there is any chance to ensure that when the Postal Service, a year after enactment of our bill, for example, that they decide not to go to 5-day-a-week service, it is for them to have found ways, innovative, new products, new ways to generate revenues off this legacy organization. And the other thing is to find ways, especially on the health care side to save money. That is the 800-pound gorilla here in the room. I know you all are working on that and I would ask that we just continue to do that, good conversations, good negotiations. I would just urge you to keep those up. Mr. Beeder.

Mr. BEEDER. Affordable rates are critical to consumers' participation in the Postal system and the provisions in this bill raise the prospect of a number of negative outcomes. Without adequate review, it is likely that inappropriate rate increases could be imposed with no practical remedy available to mailers. The USPS oversight not only provides price stability, but also fairness among mailers, subject to the monopoly provisions of the non-competitive categories.

Chairman CARPER. Good. Thank you, sir. Mr. Cerasale.

Mr. CERASALE. Yes. The monopoly is something that we are concerned about. The CPI cap has been an incentive to rein in postal costs and without it, we think or fear it is too easy to raise postage. And in the scoring battles we have had in previous postal reform legislation, the Congressional Budget Office (CBO) has found increasing postage decreases the likelihood of cost-cutting. And I would be very worried about that.

Chairman CARPER. Thank you. Mr. Weisberg.

Mr. WEISBERG. I would like to help us all leave on a positive note. The Postal Service has done a fantastic job in working with the PC postage industry and is just starting to reap the benefit of that growth. There is a huge opportunity in the growth of e-commerce shipping and we look forward to working with the Postal Service to help get the benefits of it.

Chairman CARPER. Thanks. Dr. Coburn, any last word?

Senator COBURN. No. I would like permission to put just a little statement into the record on cross-subsidization, statements of Mr. Cerasale that he has made in terms of 1996[1] and 1998 where his industry was worried about cross-subsidization.

Chairman CARPER. Good enough. Without objection.

[1] Additional information submitted by Senator Coburn appears in the Appendix on page 221.

We are at the point to adjourn. I just want to again thank you very much for being here, for preparing for your testimony, and for giving it, for answering my questions. I also want to say, I see behind Mr. Cerasale the Postmaster General. We asked him to stay. We are delighted that he stayed.

We have another hearing. Some of you will be back. But whether you are at the hearing and speaking, we are going to have some time for continuing this dialogue. I think I leave here more encouraged than not. There was hope in a hopeless world. And we have to keep working hard to get there and I think we will. God bless you. Thanks so much.

[Whereupon, at 12:44 p.m., the Committee was adjourned.]

APPENDIX

Opening Statement of Chairman Thomas R. Carper
"Outside the Box: Reforming and Renewing the Postal Service, Part I – Maintaining Services, Reducing Costs and Increasing Revenue Through Innovation and Modernization"
Committee on Homeland Security and Governmental Affairs
September 19, 2013

As prepared for delivery:

We meet today to examine the financial challenges facing the United States Postal Service, and to consider proposals that have been put forward to address those challenges.

Since I first joined this committee in 2001 as a freshman senator, one of my top goals has been to not just help the Postal Service get by, but to help it be strong again and remain viable for the long term.

Back in 2006, I worked with Senator Collins, Senator Lieberman, our House colleagues, and others to enact legislation intended to give the Postal Service the tools it would need to deal with the challenges posed by the increasing use of electronic forms of communication. We had no idea at the time that the worst recession since the Great Depression lay just around the corner and that it – along with the growing use of email, electronic bill pay, and other communication innovations – would so dramatically erode mail volume.

Today, as I've mentioned before at this committee's hearings and in other venues, we find ourselves closer than we've ever been to losing the vital services that the Postal Service offers, along with the 8 million or so jobs that depend on its continued vitality.

As we sit here today in the fall of 2013, the Postal Service has maxed out its credit line with Treasury and is rapidly running out of cash. Despite an improving economy and some positive signals from package delivery and advertising mail, the immediate future is unfortunately not very bright for the Postal Service. Absent legislative intervention, the Postal Service will likely limp along for a few months unable to invest for the future, and with its employees and customers uncertain of what that future holds. It can only limp along this way for so long.

This situation is unacceptable. It is also avoidable, and calls for urgent action from Congress and the administration. Unfortunately, despite repeated requests from postal management for assistance, we've failed to act. After months of effort to find common ground, however, Dr. Coburn and I finally succeeded in introducing bi-partisan, comprehensive legislation on August 1st that has the potential to set the Postal Service on the path towards self-sufficiency and relevance in the 21st Century.

Our bill attempts to permanently address the Postal Service's long-standing health and pension issues and right-size its processing and delivery network, while providing it with the tools to generate new revenue in the digital world.

My goal with this bill — and I believe Dr. Coburn's goal as well — is to enact a set of reforms that are fair to postal employees, to postal customers, and to taxpayers. Our further goal is to fix this problem – at least for the foreseeable future – and not to kick the can down the road.

Our hearing today will focus largely on the provisions in our bill that relate to postal rates, potential changes in the level of service provided by the Postal Service, and the innovations that postal management must put in place in order for the Postal Service to survive and thrive in the coming years.

It's important to note at this point that, despite the relatively positive financial news we've seen in recent months, tough decisions are still needed in order to get the Postal Service out of the troubles it faces. Whether it happens today, next month, or next year, it's likely that postal customers will need to sacrifice at least some of the conveniences they enjoy today. Our bill would give the Postal Service the authority it needs to adjust its operations to reflect the changing demand for the products and services it offers, and the changing needs of its customers.

The Postal Service today needs to be granted the authority from Congress to make decisions similar to those that our auto companies made in recent years in right-sizing that industry and enabling it to succeed despite the challenges it faces in the 21^{st} Century marketplace.

But the solution to this problem we're gathered here to discuss can't just be about cuts. It has to be about innovation and finding a way for the Postal Service to be almost as important to my sons as it was it my generation while we served our country during the Vietnam War, and to my parents' generation during World War II.

The Postal Service has been attempting to do just that. It has aggressively marketed its package offerings and made them more user-friendly and valuable to customers. It has also partnered with companies such as FedEx, UPS, and Amazon.com to deliver items the last mile to their customers.

For example, in my state, Amazon.com sends trucks out every night from its plant in Middletown to Postal Service facilities all over the mid-Atlantic and northeast to deliver overnight items that people have ordered online.

The bill that Dr. Coburn and I have put forward would help postal management with its efforts. It would also expand the range of products and service the Postal Service can offer by eliminating what was, in retrospect, a short-sighted restriction placed on postal innovation in 2006. Our provision – along with others such our language allowing the Postal Service to compete with UPS and FedEx in the shipping of beer, wine, and spirits – is intended to give postal management the tools they need to make greater use of its one-of-a-kind processing, distribution, and retail network.

At the end of the day, what Congress must do is to provide some certainty to both postal employees and customers, and to ensure that taxpayers — along with all of the fiscal challenges we face as a country — are not also saddled with shoring up a failing Postal Service. I don't want to be back here in a few years discussing how we can dig ourselves out of yet another postal crisis. I don't believe any of us want to do that. As it turns out, if we're smart enough, and creative enough, and bold enough, we won't have to.

UNITED STATES POSTAL SERVICE

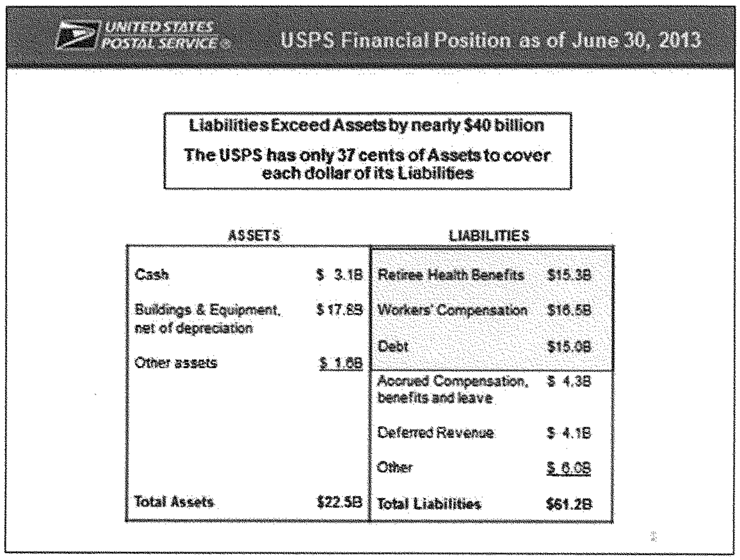
STATEMENT OF
POSTMASTER GENERAL AND CHIEF EXECUTIVE OFFICER
PATRICK R. DONAHOE
BEFORE THE
COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

SEPTEMBER 19, 2013

Good morning, Chairman Carper, Ranking Member Coburn, and members of the Committee. Thank you, Chairman Carper, for your continued leadership on comprehensive postal reform legislation, and for calling this hearing to discuss S. 1486, the *Postal Reform Act of 2013,* and specifically the topics of rates, service, and innovation. Thank you, Ranking Member Coburn, for working in a bipartisan manner as an original cosponsor of the *Postal Reform Act of 2013.* The U.S. Postal Service needs comprehensive legislation that will allow us to achieve $20 billion in savings. During the 112th Congress, the Senate took action to pass bipartisan postal reform legislation in the form of S. 1789, the *21st Century Postal Service Act.* We appreciate that effort, and the effort extended by the Senate to work with the House until the final hours of the 112th Congress to find compromise on a major postal reform bill. However, those efforts ultimately did not lead to enacted legislation. We continue to urge the 113th Congress to act swiftly to pass comprehensive postal reform that will change our business model and combine with management actions to restore the financial viability of the Postal Service.

USPS FINANCIAL CONDITION

The Postal Service continues to be in a very poor financial position as the depth of its $62 billion liability could only be partially filled with $22 billion in assets, as of June 30, 2013. *[Figure 1]* The Postal Service has reached its statutory debt limit of $15 billion and it held unrestricted cash representing only 11 days of average daily operating expenses. Current projections indicate that it will continue to have a dangerously low level of liquidity in the foreseeable future. The Postal Service will be unable to make the required $5.6 billion Retiree Health Benefits (RHB) prefunding payment due by September 30, 2013. This is in addition to similar payment defaults on $11.1 billion in 2012. Our cash position will continue to worsen in October 2013, when the Postal Service is required to make its annual payment of approximately $1.4 billion to the Department of Labor (DOL) for workers' compensation expenses. By mid-October 2013, the Postal Service projects it will have a cash balance on hand of approximately five days of average daily expenses. For an organization the size of the Postal Service – which has revenues of $65 billion and a total workforce of approximately 490,000 career employees – that is a razor thin margin. By way of comparison, most private sector companies usually have available liquidity of at least two months of operating expenses.



UNITED STATES POSTAL SERVICE® USPS Financial Position as of June 30, 2013

Liabilities Exceed Assets by nearly $40 billion

The USPS has only 37 cents of Assets to cover each dollar of its Liabilities

ASSETS		LIABILITIES	
Cash	$ 3.1B	Retiree Health Benefits	$15.3B
Buildings & Equipment, net of depreciation	$ 17.6B	Workers' Compensation	$16.5B
Other assets	$ 1.8B	Debt	$15.0B
		Accrued Compensation, benefits and leave	$ 4.3B
		Deferred Revenue	$ 4.1B
		Other	$ 6.0B
Total Assets	$22.5B	Total Liabilities	$61.2B

Figure 1

The Postal Service has seen seven consecutive quarters of net losses and has recorded losses in 16 of the last 18 quarters. For the first nine months of Fiscal Year (FY) 2013, we recorded a net loss of $3.9 billion. Last year, the Postal Service recorded a net loss of $15.9 billion and defaulted on RHB prepayments to the United States Treasury of $11.1 billion. In the past six fiscal years since enactment of Congressionally-mandated prefunding, the Postal Service has incurred $41 billion of net losses, including $32 billion of expenses for prefunding RHB. As of June 30, 2013, we had $22 billion of assets versus $61 billion of liabilities – roughly 37 cents of assets to pay each dollar of liabilities. This financial condition, combined with continuing multi-billion dollar losses highlight the need for immediate legislative reform. To be clear, the Postal Service does not have the authority or the tools to manage these massive obligations without comprehensive postal reform legislation.

The results from the most recent financial quarter show a continuous decline in First-Class Mail, our most profitable category of mail. The loss of First-Class Mail is the primary driver of the decrease in profit margins that the Postal Service has experienced since FY 2007. *[Figure 2]* The most significant factor contributing to the ongoing decline is the migration toward electronic communication and transactional alternatives.

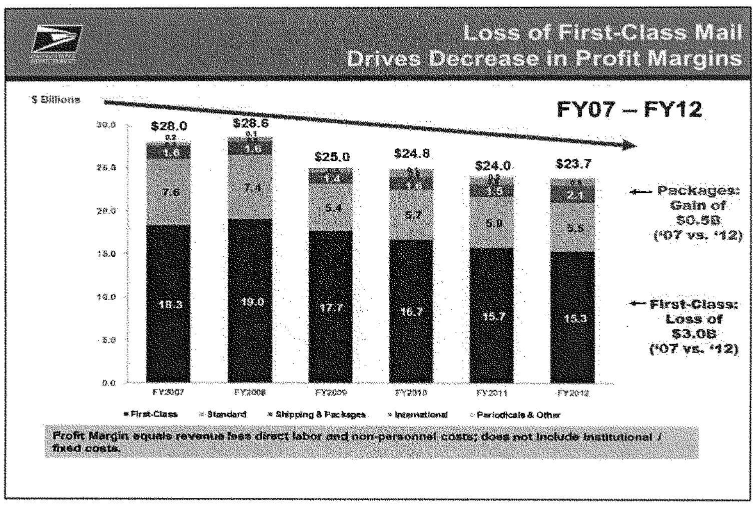


Figure 2

While the shift to electronic communication alternatives has a pronounced negative effect on First-Class Mail volume and revenue, the expansion of e-commerce and successful marketing campaigns has grown our Shipping and Package business. However, the increased revenue in Shipping and Packages does not provide enough contribution to offset the decline of First-Class Mail. Packages are far more expensive to process, transport, and deliver than letter mail. It takes approximately $3 in package revenue to make up for every dollar lost by First-Class Mail. To cover the $6 billion decline in First-Class revenue expected by 2017, package revenue would need to grow by $18 billion, or 55 percent, from its 2012 level.

The Postal Service has laid out a path forward for future growth and stability. On April 17, 2013, the Postal Service released its updated comprehensive 2013 Five-Year Business Plan, which details the implementation of its targeted program to eliminate $20 billion of annual cost from the business by 2017. The plan addresses our unfunded retirement liabilities head on, by proposing meaningful change, such as health benefit reforms that would properly integrate with Medicare either through a USPS-sponsored health plan or a redesign of some existing Federal Employees' Health Benefit Plan (FEHBP) plans. Such a plan would essentially eliminate the unfunded RHB liability primarily by integrating with Medicare, as substantially all private sector firms have done for years. Why debate amortization periods for unfunded balances when we should attack the root problem of high costs? We further address the unfunded retirement liability issue through our proposal to create a defined contribution retirement plan for employees hired in the future, one that creates a more portable retirement plan for them. Now is the time for bold and sweeping action, which will allow us to move forward with solutions that will last for years to come, instead of piecemeal efforts that will only bring us back here again, pursuing legislative reform in a few years. We need to act now to implement strategies designed not only for the Postal Service of today, but for the Postal Service of ten, and even twenty years into the future.

With the backdrop of the 112th Congress's inability to pass comprehensive postal legislation and the March 2013 decision by Congress to prevent the Postal Service from implementing a modified delivery schedule, the Postal Service's Board of Governors asked management to evaluate further options to increase revenue, including an exigent rate increase to raise revenues across current Postal Service product categories. In weighing this option, the Governors are very aware of the concerns expressed by the mailing industry about the potential negative effects that an exigent rate increase may have. These concerns, however, must be balanced against the Board's fiduciary responsibility to effectively manage the Postal Service's finances and ensure that the American people continue to receive effective mail service. While they continue to evaluate the benefits and risks of an exigent rate increase, the Governors have indicated that prompt enactment of comprehensive postal legislation that substantially addresses the long-term $20 billion financial gap would be an important factor in the decision to pursue an exigent rate increase. However, unless the Postal Service is given the legal authority to close the budget gap, an exigent price adjustment may be necessary in order to ensure that the Postal Service will be able to maintain and continue the development of postal services of the type and quality the country needs.

COST CONTAINMENT AND IMPROVED EFFICIENCY

The Postal Service has taken actions to contain costs and improve efficiency to adapt to the country's changing mailing and shipping needs. Operational initiatives have been implemented to better align network size and cost with reduced mail volumes. These initiatives include the accelerated consolidation of mail processing and delivery networks, and the reduction in hours at 13,000 Post Offices, in conjunction with the expansion of alternate retail access. We listened to the American public, and we preserved Post Offices in rural areas throughout the country. The POSt Plan keeps rural Post Offices open by matching retail hours to customer demand. In addition, there are almost 400 Village Post Offices (VPOs) now open as a way to increase access to postal products and services in rural communities. Rationalization of our mail processing facilities allows us to provide an efficient and affordable network and supporting infrastructure that corresponds to reduced mail volume. Savings from these network consolidations are, in almost all cases, more than the Postal Service anticipated, and have been implemented without forced career job losses. These extensive operational changes are being executed even as the Postal Service continues to deliver high levels of service to communities throughout America. This realignment of mail processing, retail, and delivery operations is expected to generate $6 billion in annual cost reductions by the year 2016.

The Postal Service also continues to implement efficiency measures by aligning staffing levels with projected mail volume. These staffing level reductions will be achieved primarily through attrition, as approximately one-half of career employees are eligible for retirement. Approximately 22,800 eligible employees represented by the American Postal Workers' Union (APWU) retired or separated from the Postal Service in the second quarter of fiscal year (FY) 2013, as a result of a special incentive and voluntary early retirement offer. In the fourth quarter of FY 2012, 4,275 eligible postmasters and 2,925 eligible mail handlers retired or separated from the Postal Service. The Postal Service also successfully convinced recent arbitration panels to allow for increased utilization of lower-cost non-career employees in the letter carrier and mail handler crafts, consistent with the contractual agreement with the American Postal Workers' Union (APWU), which will facilitate the realignment of staffing and workload levels and the reduction of costs. The Postal Service's current career workforce of 492,000 is the smallest it has been in decades and is down nearly 26 percent in the past five years.

REVENUE GENERATION

The Postal Service also continues to introduce new service offerings to generate additional revenue and to slow the migration of existing revenue streams to electronic alternatives. Expanded use of digital technologies, using connectivity to various websites, social media, and points of purchase are a focus in enhancing the mail experience. The July 28, 2013 rebranding of Express Mail as Priority Mail Express leverages the strong Priority Mail® brand with a money-back guarantee for next-day service to most U.S. destinations. Changes to the Priority Mail® lineup of products include features such as improved USPS Tracking®, day-specific delivery, and free insurance coverage. However, legislative action is required to give the Postal Service authority to generate new revenue and adapt to changing business conditions, as the scope of products and services that the Postal Service can offer is currently limited by law.

LEGISLATIVE REQUIREMENTS

Repairing the Postal Service's financial condition requires the comprehensive approach reflected in our Five-Year Business Plan, which is available for public viewing on our website. The plan provides a roadmap to restore financial stability and preserve affordable mail service for the American public. The major elements of the Plan must be executed within a short window of opportunity, as the longer the wait, the greater the "crisis of confidence" that will be created with our customers.

The Postal Service needs to save $20 billion annually by 2017. Much of the savings cannot be achieved without legislative action. The legislative requirements put forward by the Postal Service constitute a fair and thorough means to stabilize the Postal Service and create a platform for future growth. The requirements include:

1. Require USPS Health Care Plan (Eliminates RHB Unfunded Liability)
2. Refund FERS Overpayment and Adjust Future FERS Payment Amount
3. Adjust Delivery Frequency (Six-Day Packages/Five-Day Mail)
4. Streamline Governance Model (Eliminate Duplicative Oversight)
5. Provide Authority to Expand Products and Services
6. Require Defined Contribution Retirement System for Future Postal Employees
7. Require Arbitrators to Consider Financial Condition of Postal Service
8. Reform Workers' Compensation
9. Right to Appeal EEOC Class Action Decisions to Federal Court

Each of the Postal Service's legislative requirements is explained in further detail below.

A. FIX THE UNAFFORDABLE BENEFITS SYSTEMS IN A RESPONSIBLE MANNER

Require USPS Health Care Plan:
One of the most important proposals contained in our plan, and one which represents tremendous cost savings, is a change in the way we provide health care to our employees and retirees. More than 20 cents of every revenue dollar the Postal Service takes in is required to go toward health care costs. *[Figure 3]* The cost of this large component of our total operating costs, second only to wages, is largely outside of our control.

To put it simply, the Postal Service would already be nearly fully funded in our retiree health benefits obligations if we could fully integrate with Medicare. Significant health benefits savings are created by integrating the plan for current and future retirees with Medicare in exactly the same way it is predominantly done in the private sector by every responsible employer that offers health care benefits to its retirees, and in state and local government plans. After a retiree reaches age 65, Medicare becomes the primary insurance, and the employer plan is secondary. With Medicare responsible for paying first, the employer sponsored plan becomes much more affordable. With reduced long-term health benefits costs, the RHB liability will be cut nearly in half, eliminating the need for prefunding. However, while the Postal Service has been the second-largest employer contributor of Medicare taxes, we are not getting full value from that program, because a significant proportion of our retirees do not enroll in Medicare when they become eligible.

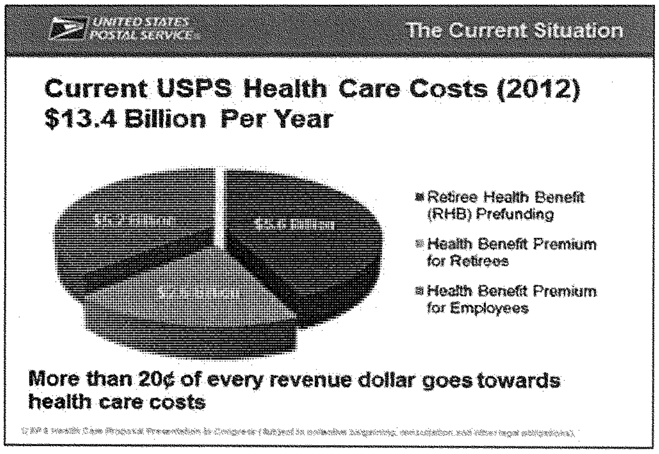


Figure 3

There is a substantial opportunity for savings – approximately $8 billion each year through 2016 – by moving to a more modern, responsive and customer-focused system. This would be accomplished by allowing the Postal Service to sponsor its own healthcare plan, or design plans within the FEHBP. Indeed, the Government Accountability Office (GAO) found in a recent report that the Postal Service would likely realize large financial gains from its proposed health care plan, which would go a long way toward putting the Postal Service on a path to solvency and long-term financial stability. The GAO also estimated that if the proposed health plan had been implemented in 2013, most postal employees and retirees would have had similar or lower premiums compared to the selected FEHB plans, with similar or higher levels of coverage for many services.

A Postal Service-sponsored health care plan that properly integrates with Medicare is critical. Without addressing the cost issue in a responsible way, the Postal Service may be unable to afford to provide health benefits to retirees. Congressional action to allow this fundamental change would dramatically reduce health care spending, and help the Postal Service take a significant step toward financial stability, by taking full advantage of Medicare Parts A, B, and D benefits. The chart below *[Figure 4]* illustrates what the FEHB Plan paid in claims costs in 2011 for annuitants who were older than 65 and had not signed up for Medicare A and B. For a retiree older than age 65, the average claims cost if the retiree had not signed up for Medicare was $10,731. By integrating with Medicare A and B, FEHB claims cost are estimated to be reduced to $4,600. Full Medicare integration (i.e. Medicare A, B, and D) would save an additional $1,200 per Medicare retiree, resulting in an average cost of $3,400. These average claim costs drive the total liability (shown on the right side of *Figure 4*). As you will note, full Medicare integration eliminates the unfunded liability for retiree health benefits.

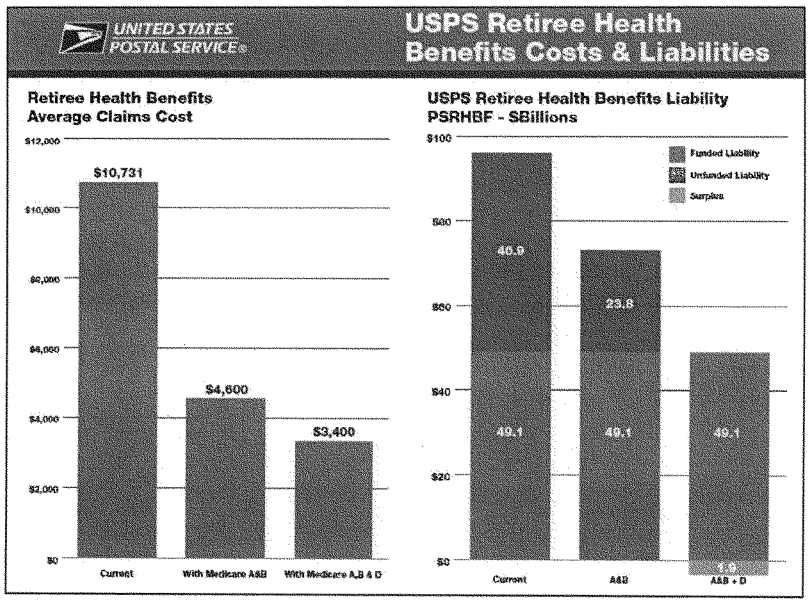


Figure 4

Refund FERS Overpayment:

Postal Service employees participate in one of three Federal government pension programs. These programs are administered by the Office of Personnel Management (OPM). OPM has determined that the Postal Service has overfunded its obligation to the Federal Employees' Retirement System (FERS). According to the most recent actuarial estimate from OPM, the Postal Service has overfunded its FERS obligation by $3.0 billion, as of September 30, 2012. This estimated surplus is less than amounts previously reported, due to changes in the government-wide economic and demographic assumptions made by OPM.

In December 2012, the Postal Service Office of the Inspector General (OIG) issued an update to a previously released paper on the causes of the FERS surplus. The Postal Service agrees with the major conclusions in the OIG's report. First, the distinctive characteristics of the Postal Service workforce, including lower salary increases than the rest of the Federal government, indicate that our FERS surplus is larger than the OPM's current calculation, and OPM should use Postal Service-specific data and assumptions to calculate the surplus. Second, in order to prevent excessive surpluses from accumulating in the future, OPM should adjust the future USPS FERS contribution rate to also take into account Postal Service-specific data and assumptions. The current FERS charges are too high, as evidenced by 20 years of surpluses, and contribute to the Postal Service's financial crisis. Third, once calculated, the current surplus should be refunded to the Postal Service. The Postal Service, using postal-specific demographics and assumptions, estimates the FERS overfunding amount to be approximately $6 billion. Directing OPM to utilize postal-specific demographics and assumptions in calculating the correct amount of the FERS surplus and returning the full amount of that surplus to the Postal Service is important, and needs to be completed this year. The Administration agrees with this approach, as evidenced in its 2014 budget request, which requires OPM to calculate FERS costs using actuarial assumptions and demographics specific to the Postal Service workforce. We appreciate that S. 1486 requires OPM to use postal-specific demographics and salary growth assumptions in calculating both the surplus and the Postal Service's ongoing contribution rate, and that it also returns the resulting surplus to the Postal Service.

Require Defined Contribution Retirement System for Future Postal Employees:

The Postal Service's current employees participate in one of three federal government pension programs, all of which include defined benefit plans. But the Postal Service is changing. Employees coming in now will likely have different careers than current employees. We should provide a retirement system that benefits both the employee of the future and the Postal Service. The Postal Service proposes this new retirement system, for future employees only, for five main reasons:

1. The ability to meet obligations under the Postal Reorganization Act (PRA).
   The Postal Service is required to provide wages and benefits comparable to those provided in the entire private sector. The FERS system is not comparable to pension programs in the entire private sector and is more costly. Permitting this move would allow the Postal Service, like the private sector, to adjust to market conditions by modifying plan design, portability, provider services, employee engagement and other factors.
2. The Postal Service's employee base is changing.
   Our emerging workforce is younger and less likely to stay with one employer for their entire career, as most of our established employees have done. This type of portable and flexible retirement program holds a greater appeal for the younger demographic.
3. Permits a reduction in labor costs.
   The Postal Service is a labor intensive organization, with labor costs making up the majority of its total costs. Benefit costs constitute approximately half of total labor costs when RHB prefunding is included. Even if the RHB prefunding requirement were removed, benefit costs would still

make up a substantial portion of the Postal Service's labor costs. We cannot resolve our fiscal problems without addressing this issue.

4. Separates Postal Service retirement system from the rest of the Federal Government.
   There continue to be ongoing debates regarding Postal Service funding of both the Civil Service Retirement System (CSRS) and FERS retirement systems. These tensions will continue, given that the Postal Service has funded substantially more of its pension obligations than the remainder of the Federal government. Allowing the separation of the Postal Service's retirement obligations would ensure that these disputes do not arise with respect to future employees.
5. Protects the American taxpayer.
   A defined contribution retirement system for future employees would help ensure that the Postal Service remains financially viable, and can therefore fulfill its obligations not only to future employees, but to retirees and current employees as well. This, in turn, provides an added level of protection for taxpayers, as it significantly lessens the possibility that taxes would have to be used to fund these payments.

It should be noted that this change would not impact the existing retirement systems for current employees. The new system would be implemented for newly hired employees in the future.

B. ELIMINATE DUPLICATIVE OVERSIGHT AND UNNECESSARY BUREACRACY

Streamline Governance Model:
In order to meet the challenges it faces both today and in the future, the Postal Service must be given the tools to become a more nimble, streamlined organization, better able to respond quickly to the needs of a dynamic marketplace and to adjust our operations as demand for products and services evolves. The Postal Service does not need additional bureaucracy to slow us down. We urgently need the flexibility to implement our Five-Year Business Plan.

The Postal Service Board of Governors should have the clear authority to make structural changes that reduce the costs of the retail, processing and delivery networks. Currently, the Governors must submit operational changes to the Postal Regulatory Commission (PRC) for advisory opinions which are then coupled with lengthy, litigious, administrative proceedings that do not promote timely and effective implementation of necessary, efficient cost reduction decisions. The current process imposes substantial costs on the Postal Service, delays the realization of cost savings and should be eliminated. S. 1486 replaces the current process with one where the Board conducts formal outreach to customers prior to implementing significant service changes, a change to the law that we strongly support. At an absolute minimum, the law should require that the PRC use substantially streamlined procedures to produce timely opinions.

Another facet of restoring financial sustainability is the growth of revenue through product and pricing innovation, both with respect to existing lines of business and new lines of business. Giving the Board greater authority to exercise business judgment in this area does not mean the end of oversight by an external entity. Rather, a more nimble and well-defined regulatory approach is required to minimize unnecessary bureaucracy, and recognize that the Postal Service faces intense competition with respect to all of its products, including those subject to the statutory monopoly. Such an approach will allow the Board to respond more effectively to changing conditions. Even the PRC has recognized, in its *Annual Report to the President and Congress*, that the current system of regulation is not achieving the objective of financial stability.

Giving the Postal Service greater flexibility over pricing and product innovation would further advance the goal of providing universal service in a financially sustainable manner. The Postal Service faces intense competitive pressures, and has strong commercial incentives to be efficient and responsive to its customers' needs. Extensive price and product controls are therefore not necessary to protect customers, as has been recognized in other countries that have streamlined their regulation of the post in recent years, including countries that, like the United States, continue to have a government post whose provision of universal service is supported by a monopoly. Governors' decisions on new products and pricing should be subject to after-the-fact reviews (like the current Annual Compliance Determination) or handled through the complaint process. S. 1486 has language that would implement such a system with respect to market-dominant products, which we strongly support.

Pairing much greater flexibility over pricing and product innovation with additional flexibility to address network costs would put the Board in a position to create a multi-faceted and balanced approach to restoring financial stability. The Postal Service's white paper, detailing these streamlined governance proposals is submitted, along with this testimony, for the record.

Adjust Delivery Frequency (six-day package/five-day mail):

In February 2013, the Postal Service put forward a proposal to move to a six-day package/five-day mail delivery schedule. Savings projected from this move (net of the cost of Saturday package delivery, primarily by non-career carriers) are estimated to be approximately $2 billion annually when fully implemented. The proposal provides mail delivery to street addresses Monday through Friday. Mail addressed to P.O. Boxes would continue to be delivered on Saturdays. Post Offices already open on Saturdays would not be affected by this proposal. Packages would continue to be delivered six days per week, and our Priority Mail Express offering, currently delivered seven days per week, would not be impacted. The proposal was designed to serve a dual purpose: first, to respond effectively to the increase in package growth, a 14 percent volume increase over the last two years, secondly, and to address the realities of the public's changing mailing habits. By continuing to deliver Priority Mail Express, Priority Mail, and most other packages on Saturday, the modified plan responds to many of the concerns expressed by the PRC and others about the impact of five-day delivery on certain customer segments, such as recipients of medicine.

We believe the timing is right to implement this change, especially in light of overwhelming continued support for five-day mail delivery by a vast majority (over 80 percent) of the public. Additionally, in his FY 2014 budget proposal, released on April 10, the President again included a provision to allow the Postal Service to move to a five-day mail delivery schedule. We appreciate that S. 1486 would allow the Postal Service to move to a five-day schedule, though we request that the one-year delay required in the bill be shortened or eliminated.

Authority to Expand Products and Services:

The Postal Service must be allowed authority to establish new revenue sources and respond to a changing marketplace. Provisions contained in the Senate bill will be helpful in providing flexibility to the Postal Service to offer products and services that would improve our net financial position. S. 1486, grants the authority to introduce new non-postal services and governmental services, and permits the Postal Service to ship beer, wine, and distilled spirits. Such changes are vital to our ability to grow additional revenue and leverage our strengths.

The Postal Service is fully engaged in exploring all options available to us under our existing legal authority. For example, we are currently focused on ensuring our presence in the digital world, through the work done by our Secure Digital Solutions group. Potential product offerings and services include identity and access management services and secure messaging. The Postal Service is confident that it can leverage critical brand components, such as trust, convenience, security and privacy. The Postal Inspection Service, the law enforcement arm of the Postal Service, plays an important part in our efforts to move into the digital realm. The Postal Service has been named the Most Trusted Government Agency for seven years and the fifth Most Trusted Business in the nation by the Ponemon Institute. We value that trust and we intend to build upon it, in both the physical mail and the digital mail worlds. Our return to financial viability is dependent on finding innovative ways to use the mail. A critical part of that is obtaining legislative change that will enable the Postal Service to offer additional products and services and improve our financial condition.

C. CHANGES NECESSARY TO PUT THE POSTAL SERVICE ON A LEVEL PLAYING FIELD

Require Arbitrators to Consider the Financial Condition of the Postal Service:
More than 85 percent of the Postal Service's career employees are covered by collective bargaining agreements. By law, when the parties are unable to conclude an agreement through negotiations, they must resort to final and binding interest arbitration, meaning that at impartial third party writes their contract. This process is of crucial importance to the Postal Service, as approximately 80 percent of its expenses are labor costs.

Interest arbitrators should be required, by law, to take into account the Postal Service's financial condition when issuing an award of a multi-year collective bargaining agreement worth tens of billions of dollars to the parties. While some interest arbitrators do consider the Postal Service's financial condition, there is no legal requirement that they do so. The past several years have focused the attention of the Postal Service and the Congress on the Postal Service's financial situation; interest arbitrators should be directed to apply the same focus. S. 1486 would require arbitrators to consider the financial condition of the Postal Service when rendering decisions, which the Postal Service supports.

Reform Workers' Compensation:
Postal employees injured on the job are covered by the Federal Employees' Compensation Act (FECA), administered by the Department of Labor's (DOL's) Office of Workers' Compensation Programs (OWCP), which makes all decisions regarding injured workers' eligibility for benefits. The Senate bill, S. 1486, would substantially reform the workers' compensation process for the entire federal government, and we applaud the Senate's efforts in this vein. Specifically, similar to many state systems, the Senate bill would require employees who receive long-term workers' compensation benefits to retire upon becoming eligible to do so. While we endorse this change, there is another modification of the current system that is necessary: allow the Postal Service to settle workers' compensation claims. While many state systems allow employers to settle these claims, current federal law does not. Allowing the Postal Service to settle workers' compensation claims would be fair to the employees and beneficial for the Postal Service.

Right to Appeal EEOC Class Action Decisions to Federal Court:
The Equal Employment Opportunity Commission (EEOC) currently possesses largely unreviewable authority in applying employment discrimination statutes to federal employers. While individual employees and applicants for employment may file actions in the federal courts when they are dissatisfied with the Commission's decisions, federal employers do not have that right. Class actions certified by the EEOC are a particular problem for the Postal Service, given the size of these cases. For example, the Postal Service is currently litigating a class action before the EEOC with more than 130,000 putative class

members. The EEOC does not apply the same class certification rules that the federal courts do, meaning that large and unmanageable cases are often certified as class actions under circumstances that would not pass muster in federal courts. Even class actions with no merit can cost millions of dollars to defend. Under current law, if a class is certified improperly, the Postal Service cannot initiate a challenge to the certification decision in federal court. We propose that this be changed, and that the Postal Service be allowed to seek judicial review of EEOC decisions certifying class actions.

POSTAL SERVICE ACTIONS

The Postal Service's updated Five-Year Business Plan eliminates nearly $20 billion of annual cost from the business by the year 2017. *[Figure 5]* By carefully managing what is within its control, the Postal Service is currently running ahead of plan in FY 2013.

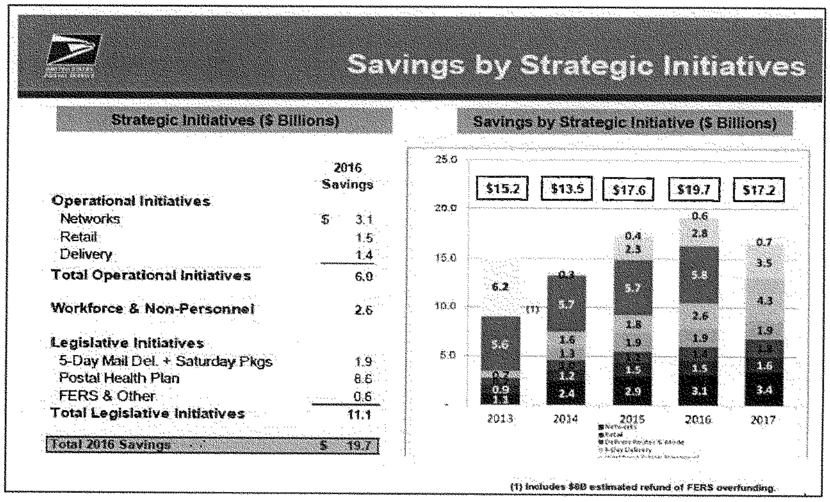


Figure 5

The actions of the Postal Service alone are not enough to return us to profitability, and we continue to pursue all avenues for change. The Plan requires a combination of operational realignment, aggressive cost reductions, and comprehensive legislation, as described earlier, to reform the Postal Service's current business model. Several key provisions include better alignment of network size and cost with reduced mail volumes, revenue management and increased growth, the implementation of a USPS sponsored healthcare plan for active and retired employees, and business model changes, including implementation of a new delivery schedule.

CONCLUSION

The Postal Service continues to make great strides in adapting to the country's changing mailing and shipping needs. However, our efforts are severely limited by a statutorily-mandated, restrictive business model, and by excessive, bureaucratic oversight that prevents the Board and postal management from effectively running the business. We have the responsibility to provide and to fund universal service for our nation, but we do not have sufficient authority or flexibility to efficiently carry out that mandate. Postal reform legislation is urgently needed. In its absence, continued significant net losses are inevitable. If provided the ability to make needed changes, the Postal Service has a bright future. We could again be a model of self-sufficiency. I look forward to the swift passage of legislation and the end to Congressional hearings discussing the Postal Service's financial losses. Then, we can finally shift our full attention back to what is really important to the men and women of the United States Postal Service - delivering for the American people.

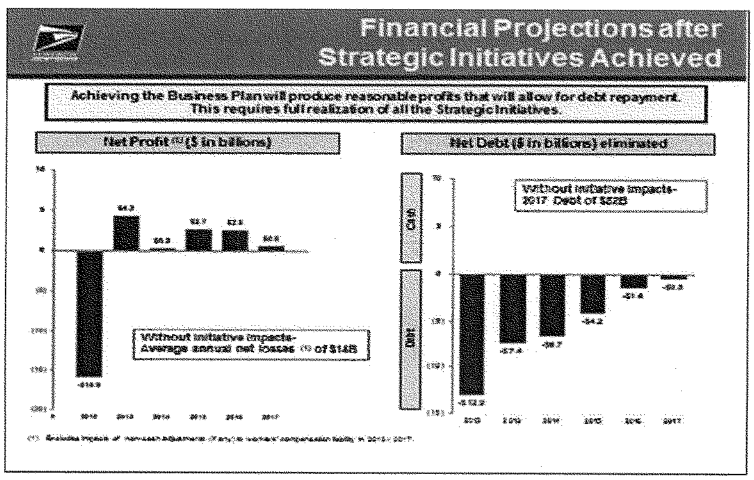


Figure 6

Simply put, the enactment of comprehensive postal reform legislation cannot wait. The Postal Service has exhausted its borrowing authority, faces massive unnecessary unfunded liabilities, and is constrained in how far it can go to bridge the massive gap between revenues and expenses. In no uncertain terms, the Postal Service does not want to become a burden on the American taxpayer. The successful implementation of strategic initiatives included in our Five-Year Business Plan would bring tremendous results, allowing for increased net profits and elimination of existing debt. *[Figure 6]* We cannot get there by our actions alone, however. There exists no scenario where the Postal Service returns to financial stability without enactment of postal reform legislation. Comprehensive and wide-ranging postal reform legislation, as opposed to narrow piecemeal efforts, is desperately needed. We must avoid a situation where the Postal Service's financial crisis causes mailers to seek out alternatives. Mr. Chairman, we look forward to continuing to work with you and the rest of the Committee to accomplish meaningful postal reform legislation.

Testimony of Ruth Y. Goldway
Chairman

Postal Regulatory Commission

before the

U.S. Senate Committee on Homeland Security and Governmental Affairs

September 19, 2013

Chairman Carper, Ranking Member Coburn, and members of the Committee, thank you for the opportunity to testify today. I am pleased to represent the Postal Regulatory Commission and to share its views on the important topic of postal reform. We appreciate your leadership in shaping the debate on what must be done to assist the United States Postal Service and ensure its sustainable future.

The Postal Service has an impact on the everyday lives of virtually every citizen in the Nation and will continue to do so well into the future. Even in this age of digital communications, a healthy, viable Postal Service remains an essential part of our Nation's infrastructure. A sizable portion of the U.S. population still depends on the mail to help manage their lives, and to communicate with businesses, governments, and social institutions.

In 2012, the Federal Communications Commission (FCC) reported that in rural areas, nearly a quarter of the population —14.5 million people—lack access to fixed broadband service at threshold speeds, while in tribal areas, nearly one-third of the population do not have access. In total, approximately 19 million Americans—6 percent of the population—lack access. The FCC also found that even in those areas where broadband is available, approximately 100 million Americans do not subscribe.

The fact is that mail remains the one universal service connecting all American people. And Americans place great trust in the Postal Service. In Ponemon Institute's Most Trusted Companies for Privacy Study, the Postal Service was ranked fourth, and it has been named the "Most Trusted Government Agency" for seven years in a row. The Commission is proud of its role in ensuring that the Postal Service functions as an open, transparent agency that is accountable to the public it serves.

The Committee has convened this hearing to explore how the Postal Service can be renewed and reformed to thrive in this changing environment, and to examine the solutions set forth in S. 1486. The Committee asks that the Commission's testimony focus on postal services, particularly regarding delivery schedules, delivery standards, and post office services. It also requests that the Commission's testimony address possible changes to the ratemaking system and innovation at the Postal Service, including new products and services. My testimony emphasizes the importance of transparency and accountability in the efficient provision of postal services and addresses the Commission's experience and views.

Key Elements of Renewal and Reform

There is broad agreement that legislative changes are needed to place the Postal Service on more sound financial footing. However, the Postal Accountability and Enhancement Act (PAEA) contained numerous reforms that were a positive force for change toward modernizing the Postal Service and that provide a solid foundation for the future. In many respects, the PAEA has been largely successful in improving postal policy and accomplishing a number of laudable Congressional goals. Efforts to renew and reform the Postal Service need not, and should not, replace the many positive provisions included in the PAEA.

The PAEA sought to increase the transparency and accountability of the Postal Service. The Postal Service is required to file periodic financial reports with the Postal Regulatory Commission within 90 days of the end of each fiscal year. The Commission is required to review the Postal Service's Annual Compliance Report and public comments. The Commission must publish its findings and, if any violations are found, order remedial action. This public process has significantly improved the transparency and accountability of the Postal Service.

Another important improvement made by the PAEA was to increase the accuracy and integrity of the Postal Service's internal controls over financial reporting. The PAEA implemented this goal by requiring the Postal Service to comply with certain Sarbanes-Oxley Act's reporting requirements and submit such reports to the Commission. Compliance with these requirements has aided in the standardization and streamlining of the Postal Service's business practices, processes, and systems. It also has enabled timely identification and remediation of weaknesses, increased accountability, and fostered ownership of controls. The strengthening of controls over business mail processes, including the prevention of lost revenue, has produced substantial indirect financial benefits.

Delivery Schedules

The Commission's experience with potential changes to the Postal Service's delivery schedules has occurred as a part of a Postal Service request to the Commission for an advisory opinion on a change in the nature of postal services. In Docket No. N2010-1, the Commission reviewed a Postal Service request to discontinue delivery of mail to street addresses on Saturdays. Based on extensive public contributions, the Commission provided advice to the Postal Service highlighting the impact of the proposal on rural, remote, and non-contiguous areas, and the importance of retaining delivery of prescription medications. The Postal Service has taken these concerns into account in developing its most recent proposals for altering delivery schedules.

This demonstrates the value of examination by an independent third party of a public record that includes comments from both senders and recipients of mail. This process contributes significantly toward ensuring that far reaching changes to postal services are consistent with the public need and avoid unintended negative consequences to those dependent on the Postal Service.

The current process is not without flaws. There was valid criticism that the quasi-judicial process used to conduct this and other Commission advisory opinion cases could be too time consuming, and that Commission advice would be more useful if it could be provided in a more timely manner. The Commission is responding to these concerns. We issued a Notice of Proposed Rulemaking requesting comments on procedures designed to condense the time for Commission analysis and decision making to three months. The final date for comments was August 28, 2013. We have received many thoughtful comments and suggestions relating to our proposal and have been actively evaluating them. Consistent with our other responsibilities, we plan to establish new rules that streamline the process in the near future.

Delivery Standards

The Commission's experience with potential changes to the Postal Service's delivery standards has occurred in two areas. First, the PAEA provided the Commission with a role to increase the Postal Service's accountability and transparency regarding service performance and measurement. Second, the Commission has conducted an advisory opinion proceeding regarding a Postal Service request to alter its delivery standards on a nationwide or substantially nationwide basis.

The PAEA sought to place a new emphasis on service performance and measurement to ensure that the Postal Service's quality of service does not deteriorate under the CPI price cap system. Degrading service is not an acceptable means of saving costs to offset lower revenue from price cap requirements. The PAEA implemented this goal by requiring the Postal Service to greatly enhance service measurement and reporting. It also required the Commission to review these reports as part of its Annual Compliance Determination.

Consistent with the aphorism "what is measured is what is fixed," the Postal Service's reports of on-time performance have shown improvement since the passage of the PAEA.

The Commission has found in its Annual Compliance Determinations that service performance for most market dominant products has been moving toward meeting their respective annual on-time targets. The fourth quarter of FY 2011 was the first quarter that the Postal Service reported service performance results for the majority of its market dominant products. In its FY 2011 ACD, the Commission noted that the level of Full Service Intelligent Mail participation was impacting the reliability of many service performance results but that it appeared the Postal Service was having difficulty meeting its service standard goals for most market dominant products. The Commission stated that it regards low performance results for speed of delivery an important issue the Postal Service must resolve.

In its FY 2012 ACD, the Commission found that most market dominant products showed improvement toward meeting annual on-time targets. The majority of First-Class Mail products, Special Services products, and Package Services products either approached or exceeded annual service performance targets. Although many Standard Mail products did not meet annual on-time targets, service performance improved throughout the fiscal year.

As of the third quarter of FY 2013, both First-Class Single-Piece and Presort Letters and Cards are meeting the service performance targets. Standard Mail products have continued to make strides toward meeting their on-time targets. Both Standard High-Density and Saturation Letters and Flats are meeting their targets and Standard Letters is achieving 88.4 percent on-time performance, within 2 percentage points of its 90 percent target.

The Postal Service and the Commission are continuing to work together to improve the Postal Service's service performance measurement systems. As measurement systems become more robust, the Postal Service should become better able to quickly identify and resolve service problems.

In Commission Docket No. N2012-1, the Postal Service requested an advisory opinion on a proposal to consolidate mail processing and transportation operations that were expected to result in changes to its service standards for First-Class Mail, Periodicals, Package Services and Standard Mail. The evidence submitted by participants in the Commission's public proceeding identified potential service and efficiency problems with the proposal. The Commission found that network rationalization, if implemented properly, could realize substantial cost savings while preserving most current service levels. It recommended the Postal Service add more structure to its phased approach. This would allow the Postal Service to evaluate the success of each phase prior to implementing subsequent phases in order to incorporate lessons learned from earlier phases.

Post Office Services

The Commission's experience with potential changes to the Postal Service's retail services has occurred in connection with several Postal Service requests for advisory opinions regarding changes in the nature of postal services and the numerous appeals filed following one of those proposals. In Commission Docket No. N2009-1, the Postal Service requested an advisory opinion on a proposal to close thousands of its station and branch retail facilities. Through a transparent and open public process, the Commission provided guidance, identifying weaknesses of the proposal and making constructive recommendations to improve the Postal Service's retail facility optimization plans and discontinuance processes. Subsequent Postal Service retail facility optimization plans submitted to the Commission for review, including the most recent efforts known as "POStPlan," incorporated this prior Commission advice by allowing Post Offices to remain in operation with modified retail hours and implementing improved procedures to obtain public input before closing retail facilities.

The proposed legislation clarifies that patrons served by stations and branches can appeal to the Commission when their post office is closed. This resolves a long-standing disagreement between the Postal Service and the Commission and should eliminate confusion on this point.

Ratemaking System

The Commission has significant experience regarding implementation of a modern system of rate regulation for postal services. A major focus area of the PAEA was postal ratemaking. It sought to end the Postal Service's reliance on unpredictable price increases and concerns that the Postal Service was passing along the costs of less than optimally efficient operations to mailers through cost-of-service ratemaking. The PAEA achieved these goals by introducing a regulatory price cap regime for Postal Service products over which it enjoys a statutory monopoly or possesses market power. The Postal Service's rate adjustments for these so-called market dominant products are now completed at predictable intervals, and rate increases for each class of mail are capped at the rate of inflation.

This rate cap approach has had positive impacts in many areas. Most importantly, it has protected ratepayers from large, unpredictable rate increases that were permissible under the old law. This ability to accurately budget for rate increases has reduced disruption to mailer operations and permitted mailers to plan their mail programs with regular reliability.

Moreover, the requirement that the Postal Service justify price increases based on extraordinary or exceptional circumstances to an independent, impartial regulatory body has guarded customers from unwarranted exigent price increases. This protection is particularly important in a government mandated monopoly environment.

The PAEA sought to eliminate the lengthy and expensive rate case litigation that occurred under prior law. The PAEA implemented this goal by providing the Postal

Service with increased flexibility to set prices within the bounds of the inflation-based price cap regime, and requiring the Commission to design and implement a modern system of rate regulation. The Commission developed a simplified process that replaced the 10-month adversarial proceeding required under prior law. The new process has made rate cases relatively uncontroversial and has significantly decreased litigation-related expenses for both the Postal Service and the mailers and organizations that formerly participated in rate cases.

Since passage of the PAEA the Commission has reviewed rate adjustment proposals to assure compliance with the law promptly and efficiently. Negotiated service agreement reviews have taken an average of only 18 days. Excluding the one exigent rate case, rate requests were completed, on average, in 37 days. The Commission completed its one exigent rate request in 86 days. No mailer has filed a complaint related to a rate reviewed and approved by the Commission.

The PAEA also sought to modernize postal ratemaking by placing the Postal Service on a more level playing field with respect to its private sector competitors in those areas where it faces direct competition. To implement this goal, the PAEA divided Postal Service products into market dominant and competitive categories, and tasked the Commission with maintaining an accurate division between these categories as the Postal Service's product mix changes. This system has provided the Postal Service with significant flexibility to price its competitive products at market rates. The Postal Service has taken advantage of this increased flexibility and the growth in the package delivery industry to increase its revenues. In the first nine months of FY 2013, the Postal Service's shipping and package product revenue increased by 7.5 percent and volume increased by 5.7 percent.

The price cap also has successfully motivated the Postal Service to implement extensive cost-cutting strategies and increases in efficiency.

One of the largest contributors to Postal Service cost savings are reductions in employee workhours. While some of these reductions are related to the declines in Postal Service volumes, they also reflect improved total factor productivity.

The recent history of wage negotiation also seems likely to have been strongly influenced by the PAEA's strict limitations on allowing the Postal Service to increase prices above the rate of inflation. During the first three quarters of FY 2013, the Postal Service took advantage of flexibilities negotiated with its employee organizations, and reduced career employee workhours by approximately 41 million hours (equivalent to the work of over 34,000 employees) while increasing non-career employee workhours by approximately 30 million hours. Similarly, during FY 2012, the Postal Service reduced total employee workhours by approximately 27 million hours, or 2.3 percent from 2011.

In addition to workhour savings, the Postal Service reports that it realized other significant cost savings during the first three quarters of FY 2013 through consolidation of 104 mail processing facilities; a reduction in operating hours at 7,397 Post Offices as part of the Postal Service's "POStPlan;" and the consolidation or reduction of 1,156 delivery routes.

Between 2006 and 2012, the Postal Service closed more than 180 mail processing facilities, disposed of nearly 4,000 pieces of equipment, reduced city delivery routes by 21,000, and decreased its career employee rolls by more than 110,000. As of June 30, 2013, the Postal Service's career workforce size is at a level last seen in 1966.

Innovation

The Commission's experience with Postal Service innovation has occurred through the Postal Service requests for approval of market tests of experimental products.

The PAEA provided the Postal Service with streamlined authority to introduce experimental products, allowing the Postal Service to innovate to make its products more valuable to customers. Since the passage of the PAEA, the Commission has reviewed and approved nine market tests under applicable statutory requirements allowing for comment by interested persons, mailers, and other stakeholders in the postal community. Through this process, the Commission, the Postal Service, and the mailing community have worked cooperatively and expeditiously to facilitate market tests of experimental products as envisioned by the PAEA while preserving proper safeguards to protect both customers and competitors.

The statutory authority and rules governing market tests of experimental products have worked well, providing the Postal Service with the appropriate level of flexibility to develop and conduct market tests of new postal products. To further encourage innovation, in its Section 701 Report, the Commission recommended allowing the Postal Service to experiment with larger market tests by raising the maximum revenue limitation. Section 302 of S. 1486 would provide this statutory authorization. This should allow the Postal Service to advance more ideas aimed at increasing the Postal Service's revenue streams.

S. 1486 would allow the Postal Service to offer new, nonpostal services in addition to those grandfathered nonpostal services allowed under the PAEA. If Congress decides to allow the Postal Service to offer such services, it should include adequate safeguards to reduce the potential for unprofitable nonpostal business ventures. In addition, such safeguards should ensure that the Postal Service's entry into nonpostal markets will not distort private markets or divert Postal Service resources from its core responsibilities. Toward that end, the Commission recommends that if the Postal Service is allowed to offer certain new, nonpostal services, these services be subject to the regulatory review established by the PAEA. Adding these regulatory review and oversight mechanisms for new nonpostal services will help ensure that the Postal Service offers profitable, new nonpostal services. This will minimize the likelihood of a repeat of the problems of nonpostal service offerings in the late 1990s and early 2000s when the Commission had no regulatory review or oversight of nonpostal services.

Financial Condition

The financial wellbeing of the Postal Service has broad consequences for the U.S. economy. According to Direct Communications Group's March 2011 Mailing Industry Job Study, the Postal Service is at the core of an approximately $1 trillion industry that employs approximately 8 million Americans. The entire economy benefits from a healthy and viable Postal Service. Printing and mailing services allow the targeted delivery of news and commercial information. Individuals and small businesses rely on the Postal Service for timely delivery of millions of check payments, letters, and packages.

This is a critical time for the Postal Service. Due in large part to changing technologies and electronic diversion, the Postal Service suffered a net loss of $3.9 billion through the end of the third quarter of FY 2013. These losses have occurred despite the Postal Service's efforts to increase productivity and lower its costs. The overly optimistic schedule of payments to the Retiree Health Benefits Fund is a principal reason for the multi-billion dollar losses in recent years. The Committee will be addressing issues related to the manner in which the Postal Service funds its obligations relating to pensions and healthcare in a hearing later this month.

As a consequence of the Postal Service's deteriorating financial condition, it has had to restrain its capital spending well below average historical levels. The Postal Service's most recently filed 10-K report shows that as of September 30, 2012, capital commitments (consisting of building improvements, equipment and sustaining infrastructure investments) totaled $644 million. This marks the lowest level of Postal Service capital commitment since 1988. Similarly, the Postal Service's most recent 10-Q report shows that, as of June 30, 2013, commitments to acquire capital assets were down even further to $535 million.

These periodic reports, required to be filed with the Commission, revealed that inadequate capital investment may be putting postal operations at risk. For example, the Postal Service is currently operating within the confines of aging facilities, equipment, and transportation fleets and does not have funds for investing in technology improvements. This could inhibit its ability to deliver high-quality services, and meet the communication needs of the American public.

Timely, heightened awareness of situations such as these is valuable for all decision makers with responsibilities involving postal issues.

Lessons and Accomplishments

As a result of the reforms enacted in the PAEA, the Postal Service and the mailing industry are in a better position than they would have been under the governing standards of the previous postal law, the Postal Reorganization Act of 1970. The Commission has been an integral part in carrying out the requirements of the PAEA and making it an effective piece of legislation. The Commission's role was not to make policy, but rather to enforce many of the Congressional policies embodied in the statute. It also was given the responsibility to review certain types of policies developed and proposed by Postal Service management to ensure consistency with those standards established in the law.

An independent expert organization serves to uphold the integrity of the law by functioning as an unbiased arbiter to ensure that Congressional policy is being followed. The Postal Service plays the chief role in implementing postal policy, but without dedicated independent oversight, there will be justifiable concern that expedience may cause Congressional postal policies to not be as strictly enforced.

There are many innovative ideas being circulated for improving the Postal Service and its business model. In considering and debating those proposals, it is important not to lose sight of the fact that prompt, meaningful and focused legislative action is essential. The Commission is pleased that important issues raised in the Commission's first periodic report to the President and Congress on how well the PAEA is operating and our recommendations to improve the effectiveness and efficiency of postal laws have been addressed in S. 1486.

The Commission stands ready to assist stakeholders, the Postal Service, and members of this Committee as necessary to ensure the Postal Service can meet its challenges now and well into the future. When postal reform is enacted, the Commission will swiftly and responsibly implement the new law to ensure the Postal Service remains an effective part of the overall American communications network.

Thank you again for providing me the opportunity to testify today. I would be pleased to respond to any questions Committee members may have.

Hearing before the Committee on Homeland Security and Governmental Affairs United States Senate

OFFICE OF INSPECTOR GENERAL UNITED STATES POSTAL SERVICE

Oral Statement

September 19, 2013

David C. Williams
Inspector General
United States Postal Service

Mr. Chairman and members of the committee, I appreciate the opportunity to testify today. Starting in 2007, the Postal Service was hit with rapid volume loss due to the economic downturn and to Internet diversion.

The decline in mail volume now appears to be slowing, and the financial crisis, though serious, is leveling off. The Postal Service has taken dramatic and successful actions to optimize its network to reduced demand. A focus today, however, is on the revenue side. My office has conducted two related studies.

The first study found the Postal Service's ability to generate needed revenue under the CPI price cap is largely dependent on unlikely increases in volume. This is true for any labor intensive enterprise subject to price controls. The Postal Service's obligation to deliver daily to a growing number of addresses, alone, assures that it will remain labor intensive.

Mail volume was expanding significantly when the CPI cap was deployed. Also, at that time the monopoly – even with the universal service requirement – was a lucrative asset. These conditions suggested the need for a price control, since monopolies can be impervious to efficient market forces. In 2007 mail growth abruptly reversed. With fewer pieces of mail going to a delivery point, each remaining piece of mail had to raise more revenue to pay for the costs of delivery. Sufficient revenue above inflation was unavailable under the price cap.

Recent volume losses combined with the price cap imperil the Postal Service's ability to provide universal service while remaining self-funded. The price cap was intended to protect trapped monopoly customers, but the monopoly has lost much of its value, since there is powerful competition for each type of mail today – advertising, personal communications, business transactions, and parcels. Customers have alternatives, and the diminishing monopoly combined with the universal service requirement is now a growing liability. Our study suggested adjusting the CPI cap to take into consideration volume fluctuations and the revenue generated per delivery point.

The second study examined how sensitive postal customers are to price increases above CPI. We found that for moderate, predictable price increases, postal products generally have low price elasticity. That means small increases would provide badly needed revenue. As prices are increased, some volume will leave, but the associated revenue loss will be more than offset by revenue from the price increase. The study examined 20 years of data through 2012 and looked for any changes to price sensitivity, including from the Internet and the recession.

We are not saying that all postal customers have a high tolerance for price increases. Some customers remain price sensitive. Rather, as a whole, the demand for these products has low price elasticity. Current fears of a postal collapse are likely a far greater risk than small price increases.

Pricing freedom through efficient market forces should be used when possible. Casting them aside in favor of artificial controls has been problematic and is problematic for the Postal Service today. Efficient market forces have a long history of successfully disciplining companies. If the Postal Service loses customers with excessive prices, it will suffer the same punishing consequences as any other business.

New innovative technologies offer many opportunities to improve core Postal operations and customer service:

- Vast data, now generated throughout the network, can be mined for operational efficiencies.
- GPS can optimize routes, manage the fleet, and track packages.
- Mobile imaging can provide customers visual delivery confirmation.
- Sensors and RFID technology can digitally link postal equipment and vehicles, providing real-time visibility into all aspects of the network, joining the Postal Service to the Internet of Things.

In this remarkable, but highly imperfect digital age, citizens and businesses also face fundamental problems: loss of privacy, security, and confidentiality; the fragmentation of messaging – Toyota couldn't connect the dots between written correspondence and email complaints several years ago; the difficulty of navigating e-government services; the risk of buying online from unknown individuals; uneven broadband and banking access; and expensive e-commerce middlemen that inhibit entrepreneurs and small businesses.

The Postal Service can help address these problems:

- Secure electronic messaging can preserve privacy, security, and confidentiality for citizens and businesses.
- Storage and integration services can give people tools to organize communications in a multi-channel world.
- The Postal Service can offer seamless e-government services by supporting a digital platform with its network of post offices and delivery carriers.
- The 1) creation, 2) storage, and 3) validation of digital identities would protect against the risks of transacting with unknown people and businesses.
- Post offices can become centers for continuous democracy by serving as hubs to gather citizen input.
- The sale of single-use cash cards and the cash redemption of digital currency can provide alternatives for the unbanked, enabling their participation in commerce.
- Virtual P.O. Boxes can offer citizens and foreign buyers of U.S. goods delivery of their packages anywhere and anytime and support businesses with back-end operations such as micro-warehousing.

- The Postal Service already has a physical network underlying the emergent wired digital infrastructure. By further enabling that network, the Postal Service can assure that e-commerce is seamlessly supported by powerful fulfillment services for physical goods.

The Committee's attention on revenue and innovation is tremendously important, and prefunding, which the Committee will address next week, is also a substantial factor in the plight of the Postal Service's finances. Part of the need for price increases and the absence of investment capital for innovation are directly tied to the financial drains from prefunding. Thank you.

For the studies mentioned in this testimony, see Revisiting the CPI-Only Price Cap Formula and Analysis of Postal Price Elasticities on www.uspsoig.gov.

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Before The

Senate Committee on Homeland Security and Governmental Affairs

"Outside the Box: Reforming and renewing the Postal Service

Part 1 – Maintaining Services, reducing Costs, and Increasing Revenue Through

Innovation and Modernization"

Testimony of Cliff Guffey, President

American Postal Workers Union, AFL-CIO

CONGRESSIONAL TESTIMONY

TESTIMONY OF CLIFF GUFFEY

ON BEHALF OF

THE AMERICAN POSTAL WORKERS UNION, AFL-CIO

Good morning Chairman Carper and members of the Committee. I am Cliff Guffey, President of the American Postal Workers Union. Thank you for this opportunity to testify on behalf of the APWU.

The APWU opposes passage of S. 1486 as it is presently written. As I have said elsewhere, the bill is fatally flawed. Instead of correcting the financial problems caused by the 2006 passage of the PAEA, it would penalize the working men and women of the United States Postal Service for those problems by threatening their jobs and undermining their compensation; it would slash service to the American people; and instead of protecting the Postal Service from impending financial disaster it would result in the dismantling of our nation's postal service.

To our utter dismay, S. 1486 would remove a cornerstone of the 1970 law that created the Postal Service, by making it possible for the Postal Service to attack and try to slash the retirement and health benefits of postal workers. Those benefits are part of the federal law that created the Postal Service. By attacking those benefits, Congress would be undermining the ability of postal workers to live in security and dignity both as active workers and after they retire. We oppose any change that could lead to a cut in our health or retirement benefits.

In this testimony, we make the following points:

- The retiree health benefits pre-funding requirement must be repealed.
- USPS contributions to federal retirement accounts must be calculated on the basis of postal employee demographics and USPS overpayments into these funds must be returned to the Postal Service with no strings attached.
- The APWU vehemently opposes legislation that would interfere with the right of postal

employees and retirees to continue to participate as they do now in the Federal Employees Health Benefits Program (FEHBP) and federal retirement programs.

- The APWU will never agree to cut its members benefits, and we strongly object to this bill which would give the right to cut our benefits to a third-party arbitrator.
- The Postal Service is recklessly destroying its own mail processing network and violating mandatory delivery standards.
- Network consolidation is delaying First Class Mail and periodicals by two or three days in many places.
- Any reform bill must protect service and must preserve delivery standards and the mail processing network.
- Retail services and rural post offices must be preserved and protected.
- The cap on rates based on the Consumer Price Index (CPI) in the current law must be repealed.
- The Postal Service must be permitted to increase its revenue and use its facilities to provide non-postal services.
- Title V of the Bill, which would cut benefits for injured workers is wrong; we oppose it, and it must be removed from this bill.

Any discussion of the financial condition of the Postal Service has to begin with the fundamental cause of the USPS financial crisis, the pre-funding requirement for retiree health benefits. The pre-funding requirement not only creates most postal debt, it saps the ability of the Postal Service to provide services and prevents it from innovating and modernizing. The pre-funding mandate should be repealed in its entirety.

Similarly, it is past time for the federal government to stop holding onto excess Postal Service funds that have been deposited in federal retirement programs. Postal ratepayers have for many years been subsidizing the federal government through substantial overpayments into federal accounts. This always has been unfair to ratepayers, but now it is more than unfair, it is unsustainable. Several steps must be taken: Postal obligations to the Civil Service Retirement

System (CSRS) and the Federal Employees Retirement System (FERS) must be re-calculated on the basis of postal employee demographics; all overfunding in those accounts must be repaid to the Postal Service; there should be no restriction on how the repaid funds may be used by the Postal Service, and USPS funding obligations going forward should continue to be calculated on the basis of postal employee demographics.

Financial pressures caused by the pre-funding requirement have wreaked havoc on service. The Postal Service has closed mail processing facilities, closed post offices, lowered its service standards, and reduced hours at post offices, particularly in rural areas and small communities. The Postal Service has cut its mail processing network so deeply and so recklessly that it is now violating the standards mandated by law, standards that the Senate sought to protect when it passed S. 1789 last year. We urge this Committee, the Senate, and the Congress to insist that service standards be maintained.

We strongly oppose legislation that would permit the Postal Service, either through collective bargaining or otherwise, to begin dismantling the Federal Employees Health Benefits Program (FEHBP). Although the Postal Service claims that it can devise a lower-cost health benefits plan, that is not true. Impartial observers have examined those claims and rejected them. A leading expert on the FEHBP has testified that the Postal Service plan would "massively disrupt or destroy the FEHBP" and breach statutory promises made to millions of federal retirees. What the Postal Service wants to do is to shift costs from itself to employees, to retirees and to Medicare. This is not acceptable. It is a desperate and ill-considered attempt to deal indirectly with what should be dealt with directly – the retiree health benefits pre-funding requirement.

As this Committee has recognized, it is necessary to repeal the restrictions on the Postal Service providing non-postal services. There are many ways in which the Postal Service can use its mail processing, retail, transportation, and digital networks to provide useful new services that will enhance the Postal Service's performance, aid our communities and small businesses and help to sustain the Postal Service.

We appreciate the fact that the Chairman and Ranking Minority Member of the Committee have addressed the issue of postal revenues and the CPI cap on rates. This is a difficult issue but, with all due respect to postal ratepayers, the CPI cap is unsustainable. To preserve universal service, a better balance must be found between rates and service.

Repeal The Retiree Health Benefits Pre-Funding Requirement

The most important postal-related task facing the United States Congress is the urgent need to repeal the requirement that employee retirement health benefits be pre-funded. Seldom has there been such universal consensus in the postal community on any issue. The pre-funding burden is unbearable. It is also wrong and unfair to postal customers. As we have pointed out in testimony here and elsewhere, no other enterprise, either public or private, is required to pre-fund its retiree health benefits liability. Without this burden which was imposed on the Postal Service and postal customers beginning in 2006, the Postal Service would today be in reasonably sound condition. Although S. 1486 addresses the issue of pre-funding, it does not go nearly far enough. It still would impose an unfair and unrealistic 80 percent funding requirement that would leave the Postal Service starved for money it desperately needs to modernize and improve its services.

Virtually the entire current debt of the Postal Service has been caused by the pre-funding requirement. Pre-funding payments already paid into the federal treasury have grown to nearly $50 billion. That is more than enough. Large companies that have voluntarily chosen to pre-fund for retiree health benefits typically do not fund to a level of more than 30 percent. The pre-funding requirement should be repealed effective immediately.

There also is virtually universal agreement that Postal Service overpayments into CSRS and FERS should be made available for the use of the Postal Service. It is critically important, in addition, that the amount of those overpayments be calculated on the basis of Postal Service and postal employee actuarial data.

The APWU has made a concerted effort over the past two years to inform the American public that the Postal Service does not receive any government subsidy. It is self-sustaining on the basis of income from postal ratepayers. In fairness to postal ratepayers, Postal Service costs, including in particular the cost of funding its employees' retirement benefits, should be calculated on the basis of an accurate measurement of the real cost of postal employees' benefits. This is not only necessary to be fair to postal ratepayers and the Postal Service, it is also the most appropriate and businesslike approach to an important financial and public policy issue. So, as an initial step in preserving the Postal Service for the American people, Postal Service overfunding must be returned to the Postal Service for its use; and that overfunding should be calculated on the basis of actual Postal Service costs. Actual Postal Service costs also should be used as the basis for calculating future Postal Service contributions to its retirement funds.

For the same reasons, we oppose restrictions on how the overpayments to be returned to the Postal Service may be used. Postal management has the obligation to manage the Postal Service. It should be left to postal management, with the policy guidance of the Board of Governors to determine how to utilize available funds.

Maintain Service Standards and Preserve the Mail Processing Network

We urge the Committee to give immediate attention to the need to preserve the Postal Service mail processing network. Failure to do so will lead to a significant degradation of service that will undermine the ability of the Postal Service to survive. The value of postal services should be protected so the Postal Service can improve its competitive position and increase its revenues.

In May 2012, the Postal Service announced plans to close more than 60 percent of its mail processing facilities. To accomplish this reduction in the mail processing network, the USPS said it would have to eliminate 20 percent of the overnight delivery of First Class Mail and periodicals. The Postal Service stated that under its new service standard regulation effective July 1, 2012,, it could expand its nightly processing window, thereby reducing the number of processing locations needed in the network. The Postal Service plan called for closing or consolidating 229 plants in two phases. Phase 1 would include the closing of approximately 140 plants to be completed by February 2013. Phase 2 was to require the closing of approximately 90 more plants beginning in February 2014. As part of Phase 2 of the plan, the Postal Service planned to virtually eliminate the overnight delivery of First Class Mail and periodicals in early 2014.

This Postal Service plan was never a good one. Evidence presented to the Postal Regulatory Commission showed that potential cost savings would be offset by very substantial loss of postal revenue that would result from the lowering of service standards. The Commission concluded that the net savings from these substantial cuts in service could be as little as seven tenths of one percent (,007) of postal revenues (about $46 million annually). Advisory Opinion in PRC Case No. N2012-1, at 2.

The devastating effects of these closings and consolidations on postal services can and should be avoided by legislation that requires the Postal Service to maintain an overnight delivery standard for first-class mail and periodicals.

Information we have received from our locals around the country, and the many complaints we have heard and read from mailers, have made it clear that the Postal Service is failing to provide required services. This is happening in part because postal management has closed necessary mail processing facilities. The consequence of this destructive policy of excessive facility closures is that the Postal Service is now violating mandatory service standard regulations. Unquestionably, network consolidation is having a very negative effect on postal customers. It is delaying mail not just one day but as much as two or three days.

Exhibit A to this testimony is a Postal Regulatory Commission complaint filed by the APWU in which we protest the fact that the Postal Service is violating its Service Standard Regulations. As you will see, we have specific examples of violations from our locals in

- Tyler, Texas
- Brooklyn, New York
- Colorado Springs, Colorado
- Kilmer, New Jersey
- Saginaw, Michigan
- Williamsport, Pennsylvania
- Salem, Oregon
- LaCrosse, Wisconsin
- Carbondale, Illinois and
- Cape Girardeau, Missouri

As a consequence of these violations, the Postal Service is depriving individuals and business mailers of the service to which they are entitled by law under service standard regulations in violation of Section 3691(d) of the PRA as amended by the PAEA. 39 U.S.C. § 3691(d)

The Postal Service is discriminating against individuals, small businesses, and organizational mailers in the provision of postal services by failing to comply with its regulations providing for the delivery of First-Class Mail and other mail, particularly to those in rural areas, because the effects of service standard violations are more frequently found there. These discriminatory actions by the Postal Service violate Section 403(c) of the PRA as amended by the PAEA. 39 U.S.C. § 403(c).

In the many cases where mail processing facilities have been closed due to network consolidation, the mail must be transported from stations, branches and Associate Offices in the vicinity of the closed facility to a more-distant mail processing facility. Several things then happen that prevent overnight delivery of the mail. One is that mail that is transported longer distances may not arrive in time for overnight processing and redistribution. In an effort to solve this problem, the Postal Service typically requires that mail be collected at an earlier time in the area of the closed facility so that it can be transported to the more distant facility for processing. This means that the mail of businesses and individual mailers who deposit their mail after the earlier collection time, and all mail picked up by letter carriers that day, will not be counted as mail received on that day for the purpose of determining delivery standards. All that mail is being delayed a day because it must wait for processing until the next day. It is being delayed an entire day but that delay does not show up in Postal Service on-time statistics.

In the case of large mailing businesses with their own separate mail pickup arrangements, or that deposit their own mail at a local facility, the effect of this sort of change is to require that they prepare their mailing for pickup earlier in the day or transport it longer distances for mailing. These requirements are imposed by the Postal Service through changing its business practices. In this case, it changes the Critical Entry Time (CET) after which mail cannot receive the service it would have received. Typically when the Postal Service changes a pickup time, a box closure time, or a Critical Entry Time, the Postal Service does not acknowledge that it is not meeting its service standards. Therefore, while the customer experiences a substantial cut in service, the Postal Service does not acknowledge that fact and reports that it is still meeting its service standards.

The other thing that happens when local mail processing facilities are closed is that mail sent to a distant facility for processing, although it may be processed overnight if it can be transported to the more distant facility in time for that to occur, may not be transported back to the original facility or to the Associate Offices, stations and branches surrounding the original facility in time to be sent out with the letter carriers for delivery the next day. Mail that arrives too late either delays the carrier in leaving to deliver a route or it is left in the carrier station for delivery the following day. At times, this results in idle time while the carrier waits for mail or overtime due to carriers having to work an extended day. And it is unsafe for carriers and annoying to the public to have carriers delivering mail after dark.

The unintended delays due to closings and consolidations compound the effects of the Postal Service's formal change of delivery standards. Where the Postal Service may intend that overnight mail delivery continue, or that it be changed from one-day service to two-day service, the actual effect is greater. Substantial amounts of mail are being delayed two or even three days. This means that mail that should have been delivered on Wednesday may not be delivered until Friday. Mail intended for delivery late in the week is not being delivered until the following week.

In the case of time-sensitive mailings this means that mailers must plan and complete their mailing preparations days in advance. These problems no doubt explain why research on the effects of network consolidation and service standards changes has shown that the Postal Service will lose a substantial amount of business by delaying the processing of mail.

The unwarranted and reckless closing of mail processing facilities threatens to further weaken the Postal Service's competitive position in the critical parcel market. Studies have shown that the parcel mailing industry is one that is strong and growing, and that will continue to grow. The Postal Service is well-positioned to provide competitive low-cost services to the American public in this area. It would be very counterproductive to permit the Postal Service to so deplete its network that its ability to provide these services cannot be maintained.

The dismantling of the essential Postal Service mail processing network is tragic and unnecessary. The evidence is very clear that cost savings and efficiencies can be obtained, and many have been obtained, through less drastic closing and consolidation actions that preserve essential services.

It also is important to recognize the impact these unnecessary facility closings have on our communities and on postal workers. Where mail processing plants are closed, communities suffer economic hardship, and postal employees' lives are disrupted. Postal workers are extremely dedicated and have continued to perform at the highest levels to provide postal services. It is wrong for the Postal Service to demand sacrifices from its workers where, as in the case of these excessive facility closures and consolidations, these actions cannot be justified by net financial benefit to the Postal Service.

We urge the Committee in the strongest possible terms to amend S. 1486 by adding a provision to require the Postal Service to maintain delivery standards for First Class Mail and periodicals. We also urge the Committee to add a provision to strengthen the procedures the Postal Service must follow before closing a mail processing facility and to give the Postal Regulatory Commission authority to delay, stop, or reverse facility closing decisions.

Preserve and Strengthen Retail Services and Rural Services

As in the case of its mail processing network, the Postal Service is taking actions that are harmful to communities by closing or consolidating post offices. These actions cannot be justified by the relatively small cost savings to be gotten from them. Again, the Postal Service seems to have been stampeded into taking actions that it knows, or should know, will be counterproductive in the long run.

We support legislation that would prevent the closure of post offices and require the Postal

Service to establish retail service standards. The Postal Service should be required to conduct a detailed review and provide full disclosure of its findings at least 90 days in advance of a post office closing. The public should be given a full and adequate opportunity to oppose the closure, and the Postal Regulatory Commission should be given the authority to provide a thorough de novo review of a post office closing decision and to suspend or reverse that decision.

Legislation that would require reliance on Contract Postal Units (CPUs) would be inefficient and counterproductive. Too often today there are CPUs that are unnecessary because they duplicate postal services available from nearby post offices. This expensive duplication of postal retail outlets is inefficient; and such duplication should be eliminated. This is not to say that the APWU opposes the provision of postal services in alternative ways. We are available to work with the Postal Service in finding creative ways to extend the official Postal Service presence into non-traditional outlets.

Non-Postal Services Must Be Authorized

The need for authorization of non-postal services to be provided by the Postal Service is also extremely urgent. The subject is closely related to the subject of the Postal Service retail network. By offering non--postal services through its retail facilities, the Postal Service can strengthen its network, maintain more facilities, and provide important public services – both postal services and non-postal services. Authorized non-Postal Service and should include:

- Government services including *e*-Government services
- Micro-banking
- Check cashing
- New technology and media services
- Warehousing and logistics
- Facility leasing, and
- Public internet access services
- Driver licensing
- Vehicle registration

- Hunting and fishing licenses
- Notary services, and
- Voter registration
- Security and authentication tools including receipt and storage of confidential files and communications.
- Hybrid mail services (digital text to hard copy mail and the reverse as well as digital communication and services related to hard copy mail.
- Digital and other services related to e-commerce (for example, delivery and pickup options and payment options)

Wherever necessary, the Postal Service must be authorized to enter into cooperative arrangements with other federal agencies, state and local governments, and private enterprises.

A full discussion of these services, how they should be provided, and their importance to the communities served by the Postal Service is beyond the scope of this testimony. However, the APWU will be more than happy to provide information and assistance to the committee and its staff to facilitate legislation to authorize these services.

APWU Opposes Changes to Federal Health Benefits or Retirement Benefits

The APWU vehemently opposes legislation that would interfere with the right of postal employees and retirees to continue to participate as they do now in the Federal Employees Health Benefits Program (FEHBP). The FEHBP is a very successful and very efficient program. The Postal Service claim that it can improve on the FEHBP with its own separate plan is, quite simply, false. The effect of the sort of separate plan the Postal Service wants would be to shift costs to employees, to retirees and to Medicare.

Furthermore, the statutory right for postal workers and postal retirees to continue to participate in FEHBP is one of the cornerstones of the Postal Reorganization Act of 1970. The APWU opposes any effort to weaken the right of employees and retirees to maintain their FEHBP benefits. By making FEHBP rights subject to collective bargaining, the draft legislation would require postal unions to place their member's rights to FEHBP benefits in the hands of an interest arbitrator. That is not acceptable to the APWU. FEHBP is an efficient, low-cost, health benefits program. Postal workers and postal retirees deserve no less.

This is equally true of retirement benefits for postal employees. No worker who gives a lifetime of service to the American public as a postal worker should be asked to live in poverty while they work or after they retire. This was a fundamental premise of the Postal Reorganization Act of 1970. The APWU cannot accept any change that would deprive employees or retirees of their right to participate fully in federal health and retirement benefit programs.

APWU Opposes the Proposed Changes in Interest Arbitration

S. 1486 would create an unfair imbalance in interest arbitration by adding a requirement that an interest arbitrator must consider the financial condition of the Postal Service. By singling out this factor among many that interest arbitrators must consider, the legislation could lead an arbitrator to place too much emphasis on one factor. This is particularly true because the present financial predicament of the Postal Service is not the fault of postal workers. Postal workers do not deserve to be punished because the 2006 law imposed the insuperable burden of pre-funding retiree health benefits on the Postal Service.

By shortening the interest arbitration process to 45 days, the legislation threatens to give postal workers the "bum's rush" out of the middle class. Labor negotiations in the Postal Service take months. It is not possible for any interest arbitrator to comprehend and fully consider the numerous and complex issues that must be resolved in such negotiations in just 45 days from the date of their appointment. Mandating such a short period for interest arbitration would turn that process into a farcical charade instead of meaningful interest arbitration.

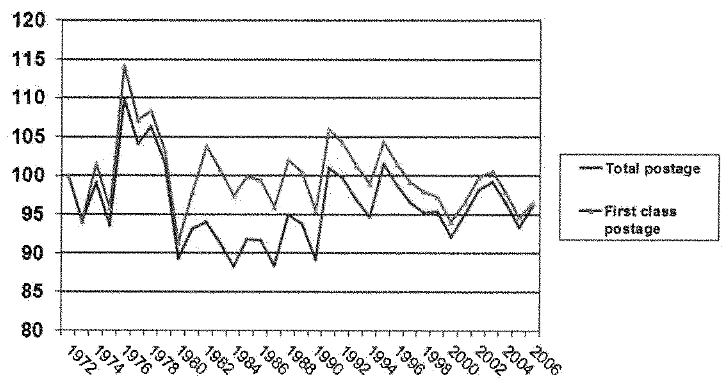
APWU Opposes Proposed Changes in the Federal Employees Compensation Act

The cuts that would be made in workers compensation benefits for all injured federal workers are unfair and have no place in postal reform legislation. Controversial and complex provisions such as those reducing benefits for injured workers when they become eligible for retirement, reducing benefits for dependents, changing the conditions for scheduled compensation benefits, to mention only some of the important provisions in Title V of the Bill, should be the focal point of separate legislation and separate hearings if they are to be considered at all. Title V of S. 1486 should be removed from the Bill.

The CPI Cap Should be Repealed

The issue of repealing the CPI cap on postal rates should be considered by looking at how postal rates changed when there was no CPI cap. As Table I shows, rates increased overall at approximately the same pace as the CPI during the 35 years the postal reorganization act permitted rates to be set to cover postal costs instead of strictly limiting them to changes in the CPI. By restricting rate increases to CPI changes and confining increases to separate classes of mail, the 2006 legislation in effect took a system that was not broken and fixed it in a way that has made it too confining and unworkable.

In Real Terms (Adjusted for Inflation) Postage Costs Were Below 1972 Levels in 2006
(1972=100)



Source: Bureau of Labor Statistics-Producer Price Indexes for USPS and CPI-W

When the 2006 law was passed, Congress recognized that there is a relationship between service and rates. The Postal Service and the Postal Regulatory Commission were required to establish service standards to provide service to the American public at fair and reasonable rates. That service includes providing universal First Class service to the American public at a uniform rate. Because of changes made due to the lack of funds, it is clear that we are now at a point where mail is being delayed and postal facilities are being closed, and the American public is no longer receiving the service it deserves from the United States Postal Service. These circumstances require that Congress reconsider the statutory CPI cap on postal rates.

There are sound policy reasons for repealing the CPI cap. It is no longer possible to argue that first-class letter mail is a monopoly that requires protection against excessive rates being exacted from mailers. Quite the opposite is true. The postal service monopoly on letter mail is necessary to protect and preserve the postal network and to continue providing universal service to the American public. But there is a lot of competition with the Postal Service, and there is no economic reason to deny the Postal Service the right to set rates that are better-aligned to the amount of demand in the marketplace for postal services.

Comparison of postal rates in the United States to postal rates in other industrialized economies shows that our postal rates are unusually low. Table I at the end of this testimony compares postal rates in this country to rates in other countries on a basis that provides a fair economic comparison.[1] These comparisons further support our point that the CPI cap is too restrictive. It has damaged the Postal Service and must be repealed.

APWU members have borne the brunt of the drastic changes made by the Postal Service in the past seven years. They have been penalized unfairly for financial problems they did not create and could not control. The APWU cannot accept efforts to impose further sacrifices on postal workers.

[1] Table I provides a comparison from 2011. An updated comparison will be provided for the record.

Comparative First Class Letter Mail Rates for Different Countries

Country		Cost in US$
United States	Up to 1 oz. (28.3 grams)	$0.44
Canada	Up to 30 grams (1.08 ozs.)	$0.61
Australia	Up to 250 grams (9 ozs.)	$0.62
Japan Post	Up to 25 grams (0.9 ozs.)	$0.71
German Post	Up to 20 grams (0.7 ozs.)	$0.78
France	Up to 250 grams (9 ozs.)	$1.07
Royal Mail (UK)	Up to 100 grams (3.5 ozs.)	$0.74
Source: Various Posts, April 4, 2011 exchange rates Cost is for sending a letter to a domestic destination that weighs approximately 1 ounce		

TABLE 1

Postal Regulatory Commission
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BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

COMPLAINT OF AMERICAN POSTAL WORKERS UNION, AFL-CIO Docket No. C2013-10

COMPLAINT OF AMERICAN POSTAL WORKERS UNION, AFL-CIO
REGARDING VIOLATIONS OF 39 U.S.C. 3661 and 3691

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September 5, 2013

COMPLAINT

I. **Background**

1. Under Section 3691 of the Postal Reorganization Act of 1970 (the PRA), as amended by the Postal Accountability and Enhancement Act of 2006 (the PAEA), the Postal Service was required to promulgate regulations establishing service standards for market dominant products, including First Class Mail, within 12 months after the enactment of the PAEA. 39 U.S.C. § 3691(a). Section 3691(b) lists four objectives the Postal Service must seek to achieve, and eight factors it must consider, when it promulgates or amends service standard regulations. 39 U.S.C. § 3691(b). Under Section 3691(a), the Postal Service "may from time to time thereafter by regulation revise" service standards for market dominant products. 39 U.S.C. § 3691(a).

2. On September 21, 2011, the Postal Service published an Advance Notice of Proposed Rulemaking (ANPR) in the Federal Register to solicit public comment on a proposal to revise service standards for market-dominant products. 76 Fed.Reg. No. 183, at 58443 (Sept. 21, 2011). The Postal Service gave as a reason for the proposed rulemaking that mail volume was falling and the resulting excess capacity in the Postal Service's mail processing network necessitated a major consolidation of that network. Id. at 58434. The Postal Service stated that the major consolidation of the mail processing network was "contingent on revisions to service standards, particularly the overnight standard for First-Class Mail." See Introduction to Revised Standards for Market-Dominant Products, 39 CFR Part 121, 77 Fed.Reg. No. 102, at 31191 (May 25, 2012).

3. Among other things, the proposed changes to service standards would extend expected delivery times for various classes of mail such as eliminating any expectation of one day delivery for First Class Mail and changing the expectation as to the percentage of First Class mail delivered within two days from 26.6 percent to 50.6 percent and changing the expectation as to the percentage of First Class mail delivered within three days from 31.6 percent to 49.1 percent. Delivery times for periodicals would also be extended.

4. The September 21, 2011 ANPR stated that by ending overnight delivery for First Class mail, the USPS could change times during which it processes mail, which is currently done between 12:30 am and 7:00 am, to 12:00pm to 4:00am the next day. The changed processing times would require mailers to deliver mail to the USPS by 8:00 am each day rather than in the evening before the start of processing at 12:30am. The ANPR further stated that as a result of the proposed service standard changes, the USPS would be able to reduce the number of its mail processing facilities from over 500 locations to fewer than 200 locations because of the longer processing windows.

5. The ANPR solicited comments on its proposal, especially comments from senders and recipients of mail concerning the potential effects of the proposed change, and specifically on how they might change their mailing practices and reliance on the mail.

6. The ANPR advised that if the USPS decided to move ahead with the proposed change, it would publish a proposed rule in the Federal Register and would request an advisory opinion from the Commission under 39 U.S.C. §3661(b).

7. On December 5, 2011, USPS filed a request for an advisory opinion under 39 U.S.C. §3661 ("Request") concerning its proposals for changes in its service standards consistent with those set forth in the ANPR. The Request said the proposed changes would "eliminate the expectation of overnight service for significant portions of First Class Mail and Periodicals"; additionally, "the two-day delivery range would be modified to include 3 digit zip code origin destination pairs that are currently overnight, and the three day delivery range would also be expanded". PRC Case No. N2012-1

8. The December 5 Request said that "[t]he service changes described in this request potentially affect every sender and recipient of mail served directly by the United States Postal Service, and are likely to affect most of them". The Request acknowledged that "[w]hen the Postal Service determines that there should be a change in the nature of postal services which will generally affect service on a nationwide basis, it is required by section 3661(b) to request that the Postal Regulatory Commission issue an advisory opinion on the service change, and to submit a request within a reasonable time prior to the effective date of the proposed service change". The Request further stated that there should be no doubt that the service changes described in the Request "will be nationwide within the meaning of Section 3661(b)". *Id.*

9. On December 15, 2011, the Postal Service published a Notice of Proposed Rule (NPR) proposing revisions to the service standards for market-dominant mail products, stating that "the most significant revision would largely eliminate overnight service for First-Class Mail." 76 Fed.Reg. No. 241, at 77942 (December 15, 2011). The Supplementary Information published with the Proposed Rule explained that "Service Standards are comprised of two components: (1) A delivery range within which all mail

in a given product is expected to be delivered; and (2) business rules that determine, within a product's applicable day range, the specific number of delivery days after acceptance of a mail piece by which a customer can expect that piece to be delivered, based on the 3-Digit ZIP Code prefixes associated with the piece's point of entry into the mail stream and its delivery address." *Id.*, at 77944.

10. Under the proposed Service Standards, "[t]he most significant effect of [the proposed] changes [would] be to drastically reduce the amount of First-Class Mail that qualifies for an overnight service standard. Under the [then] current First-Class Mail overnight business rule, intra-Sectional Center Facility (SCF) mail [was] subject to overnight delivery if it [was] entered before the applicable day zero CET." *Id.* (footnote omitted). Under the proposed revisions to the First-Class Mail overnight business rule, overnight service would be accorded only to intra--SCF Presort First-Class Mail that [was] entered at the SCF prior to the CET." *Id.*, at 77945 (footnote omitted).

11. Mail is "intra-SCF" if its destination is within its designated SCF's delivery area. Under the proposed revisions to the First-Class Mail overnight business rule, overnight service was to be "accorded only to intra-SCF Presort First-Class Mail that [was] entered at the SCF prior to the CET." *Id.*, at 77945 (Footnote omitted).

12. The NPR affirmed that the proposed changes would result in alterations of the prescribed delivery times for First Class Mail and that, as a practical matter, delivery times for other classes of mail would change as well, that the USPS would close many facilities and would change the work hours for most employees at its processing facilities. The NPR noted that the USPS had requested an Advisory Opinion from the Commission in accordance with Section 3661(b) and it cited and incorporated by

reference information it had provided in docket no. N2012-1.

13. On May 25, 2012, the Postal Service published a final rule revising the service standards for market dominant mail products, amending 39 C.F.R. § 121.1 First-Class Mail, Effective July 1, 2012. 77 Fed.Reg. No. 102, at 31190 (May 25, 2012). Under the new regulation:

> (a)(1) Until February 1, 2014, a 1-day (overnight) service standard is applied to intra-Sectional Center Facility (SCF) domestic First-Class Mail pieces properly accepted before the day-zero Critical Entry Times (CET),
>
> (2) and after February 1, 2014, a 1-day (overnight) service standard is applied to intra-SCF domestic Presort First-Class Mail pieces properly accepted at the SCF before the date-zero CET...

Id. at 31196. (Exceptions are made for Puerto Rico, the US Virgin Islands, American Samoa and parts of Alaska). *Id.*

14. Under the new regulation:

> (b)(1) Until February 1, 2014, a 2-day service standard is applied to inter-SCF domestic First-Class Mail pieces properly accepted before the day-zero CET if the drive time between the origin Processing & Distribution Center or Facility (P&DC/F) and the destination Area Distribution Center (ADC) is 6 hours or less...
>
> (2) On and after February 1, 2014, a 2-day service standard is applied to inter-SCF domestic First-Class Mail pieces properly accepted for the day-zero CET if the drive time between the origin PDC/F and destination SCF is 6 hours or less...

Id. at 31196. (Exceptions are made for Puerto Rico, the US Virgin Islands, American Samoa and parts of Alaska). *Id.*

15. The USPS stated that under the New Rule, it could expand its nightly processing window, thereby reducing the number of processing locations needed in the network. "Presently, the Postal Service's delivery point sequencing (DPS) operations are generally run for six and one-half hours per day, from 12:30 a.m. to 7 a.m. Once

implementation of Phase One [under the interim version of the New Rule] is complete, the DPS window will expand to up to ten hours, from 8 p.m. to 6 a.m. This change will facilitate the consolidation of the mail processing operations of approximately 140 facilities. Then, once implementation of Phase Two [the final version of the New Rule] is complete, the DPS window will expand to up to sixteen hours, from 12 p.m. to 4 a.m. This will make possible the consolidation of the mail processing operations of approximately 230 facilities (inclusive of the approximately 140 consolidated in Phase One)." 77 Fed.Reg. No. 102, at 31192.

16. The Postal Service explained its decision to conduct a phased implementation as follows:

> From the outset, the Postal Service has understood that implementation of Network Rationalization will require more than one year. The phased application of the new rules accommodates this reality and also provides the Postal Service with enough flexibility that, should subsequent events or changed circumstances so warrant, the Postal Service will be able to revisit the final version before February 1, 2014, and amend or withdraw it, as appropriate, through a new notice-and-comment rulemaking...

77 Fed.Reg. No. 102, at 31191-31192; and it reiterated that explanation:

> As noted above, the Postal Service recognizes the possibility that subsequent events or changed circumstances could cause it at a future date to revisit the final version of the new rules that will apply beginning on February 1, 2014, and to alter or withdraw those rules through a new notice-and-comment rulemaking....

77 Fed.Reg. No. 102, at 31192.

17. On September 28, 2012, the Postal Regulatory Commission (PRC) issued its Advisory Opinion on Mail Processing Network Rationalization (MPNR) Service Changes. PRC Docket No. N2012-1. The Executive Summary of those recommendations made the following three observations among others:

(1) "Interim service standards were adopted that preserve overnight First-Class Mail service through January 31, 2014, with the exception of First-Class Mail that is handled by more than one processing facility." *Id.* at 1.

(2) "The Commission estimates that MPNR cost savings may be as low as $46 million annually assuming mail processing productivities remain at current levels, or as high as $2 billion annually if all proposed assumptions prove correct. Cost savings may be offset by reduced contribution to the bottom line from volume loss by mailers who no longer believe the level of service provided meets their postal needs." *Id.* at 2.

(3) "The advice provided by the Commission in this docket can be succinctly summarized. The Commission views positively the network rationalization actions planned by the Postal Service through January 31, 2014, and recommends that the Postal Service take into account the considerations outlined in this Advisory Opinion before proceeding further. Specifically, the Commission encourages the Postal Service to make every attempt to retain overnight delivery in keeping with the analysis presented in the subsequent chapters [of the Commission's Advisory Opinion]." *Id.* at 5-6.

18. The Commission in its order, however, cautioned the Postal Service that the Postal Service's assumption of a systemwide increase in productivity of more than 20 percent was "remarkably ambitious and involve[d] some risk." *Id.* at 2.

19. In response to direct questions from the Chairman of the PRC, the Postal Service assured the Commission that care would be taken to ensure that intra-SCF First-Class Mail service would be maintained until February 1, 2014, and that the decision to move forward with Phase 2 would be made very deliberately. The Postal Service stated:

"... The Phase I network reflects a judgment reached by Headquarters after consultations with Area and District operations and transportation experts to determine a subset of feasible consolidations that could permit the preservation of intra-SCF overnight First-Class Mail service. Additional review may lead to adjustments to ensure that Phase I operations support applicable service standards." PRC Case No. N2012-1, Responses of United States Postal Service Witness Emily Rosenberg to Commission Information Request No. 1 (Question 8(a)(i)).

* * * * * *

"I am informed that any decision by senior postal management regarding "whether to retain phase one service standards or to proceed with implementation of phase two" will be influenced by whether a legislative enactment prohibits the Postal Service from implementing Phase II. The Postal Service also will review the advisory opinion issued in this case." *Id.* (Question 9(b)).

20. There is legislation pending in the United States Congress that would, if enacted, require the Postal Service to maintain Phase I delivery standards for First-Class Mail and periodicals.

II. Summary of Complaint

21. In this case, Complainant the American Postal Workers Union, AFL-CIO (the APWU), which together with its locals and its health plan mails millions of pieces of mail each year, complains that the Postal Service is regularly failing to comply with the Service Standards set by its regulations in violation of Section 3691(b)(1)(B) of the PRA as amended by the PAEA, which requires the Postal Service to "preserve regular and effective access to postal services in all communities, including those in rural areas or where post offices are not self-sustaining." 39 U.S.C. § 3691(b)(1)(B).

22. As a consequence of these violations, the Postal Service is depriving individuals

and business mailers, including the APWU and its locals, of the service to which they are entitled by law under service standard regulations in violation of Section 3691(d) of the PRA as amended by the PAEA. 39 U.S.C. § 3691(d)

23. The Postal Service unreasonably discriminates against of individuals, small businesses, and organizational mailers in the provision of postal services by failing to comply with its regulations providing for the delivery of First-Class Mail and other mail, particularly those in rural areas, because the effects of service standard violations are more frequently found there. These discriminatory actions by the Postal Service violate Section 403(c) of the PRA as amended by the PAEA. 39 U.S.C.§ 403(c).

24. In addition, the APWU complains that this failure by the Postal Service to comply with the law and regulations providing for postal services is the result of a decision made either by the postal Board of Governors or by postal management to implement in 2013 mail processing facility closures the Postal Service had not planned to make until after the effective date of regulation changes to take effect February 1, 2014, even though the Postal Service knew or should have known that those closures would result in the regular and systematic violation of First-Class Mail service standard regulations,

25. The APWU also complains that the Postal Service has information that it has not made public that will show the violations described above; and that information also will show that the closures planned for 2014 but implemented in 2013 have generally affected service on a nationwide or substantially nationwide basis.

26. As a remedy for these violations, the Complainant requests (1) that the Postal Service be instructed to take necessary steps to come promptly into compliance with Service Standard regulations; (2) that the Postal Service be ordered to cease and desist

from making changes in its mail processing network that will cause it to violate service standards; and (3) that the APWU and its locals be provided an appropriate remedy for any adverse impact on them due to the delay of their mail.

III. <u>Jurisdiction</u>

27. The APWU is an unincorporated labor organization with its offices at 1300 L Street, N.W., Washington, D.C. 20005. APWU is a party to multiple collective bargaining agreements with the United States Postal Service, and represents approximately 200,000 employees of the Postal Service. The APWU, its locals and the APWU Health Plan collectively mail millions of pieces of mail each year. The APWU maintains offices and conducts business throughout the United States and has Local affiliates in every state and territory of the United States; APWU and its locals send First Class Mail and other classes of mail into, and receives mail from, rural and urban districts in every U.S. State and territory. APWU locals send and receive First Class Mail and other mail pertaining to APWU business that originates and destinates in the same Sectional Center Facility (SCF). The APWU brings this Complaint as an interested person under Section 3662 of the Act.

28. Under Section 3662(a) of the PRA as amended by the PAEA (39 U.S.C. § 3662(a)) the Commission has jurisdiction to hear these complaints of violations of Sections 403(c), 3661, 3691(b) and 3691(d) of the Act and of Regulations promulgated thereunder.

29. In accordance with the Commission's Rule 3030.10(9), counsel for the APWU communicated with the office of the general counsel of the Postal Service by telephone and e-mail on Wednesday, September 4, 2013, in an effort to resolve its complaint

without the necessity of filing this action. Despite good faith consideration by both parties, further efforts to resolve this matter without the filing of this Complaint would be futile..

IV. THE POSTAL SERVICE IS VIOLATING SERVICE STANDARDS ON A NATIONWIDE OR SUBSTANTIALLY NATIONWIDE BASIS

Tyler, Texas

30. Deactivation of the East Texas P&DC was scheduled to occur after the February 1, 2014 change in delivery standards. It was re-scheduled and implemented in May and June 2013.

31. As a result of the deactivation of the East Texas P&DC, the Postal Service is consistently failing to meet the one-day service standard for First-Class Mail.

32. As a result of the deactivation of the East Texas P&DC, First-Class Mail that used to be picked up on Saturday is not picked up until Monday and then is transported for processing.

33. As a result of the deactivation of the East Texas P&DC, mail that has been processed for delivery consistently arrives late at the Area Offices. This significantly delays letter carriers' departure to make deliveries. As a result, postal patrons receive their mail hours later than they did before the consolidation. For small businesses, mail that should have been received during the business day is not received until the next business day.

Brooklyn, New York

34. As a result of recent network consolidations, both originating and destinating mail processing has been moved from Brooklyn to the Morgan P&DC in Manhattan, New York.

35. As a result of the change described in the paragraph above, a substantial percentage of First-Class Mail is not receiving one-day delivery service within the SCF where it both originates and destinates (intra-SCF mail). This is in violation of service standards.

36. The use of mail placards in the mail processing operation in Brooklyn has become irregular and no longer serves as a reliable means of determining whether mail is meeting delivery standards.

Colorado Springs, Colorado

37. The outgoing mail processing operation was moved from Colorado Springs to Denver, Colorado on June 1, 2013. As a result, cut-off times at stations and collection boxes were changed to one hour earlier. All mail dropped in those boxes after the new earlier cutoff time is delayed by one day. A substantial percentage of the mail is failing to meet delivery standards.

38. Mail that used to be processed and delivered overnight in Colorado Springs now takes two to three days for delivery.

Kilmer, New Jersey

39. The Kilmer, New Jersey, postal facility no longer processes its own originating or destinating mail. This was not scheduled to occur under the Postal Service's Network Consolidation Plan until 2014.

40. As a result of Network Consolidation affecting Kilmer, its residents receive mail that does not comply with service standards.

41. Processed mail routinely arrives at the Kilmer P&DC at 10 a.m. instead of 7 a.m. as it did before consolidation. This significantly delays letter carriers' departure to make deliveries. As a result, postal patrons receive their mail hours later than they did before the consolidation. In the case of small businesses, mail that should have been received during the business day is not received until the next business day.

Saginaw, Michigan

42. Mail originating and destinating in Saginaw, Michigan, is now transported to Pontiac, Michigan for destinating processing due to a change in mail processing that was not scheduled to occur until 2014 under the Postal Service Network Consolidation Plan but was made in 2013.

43. As a result of the elimination of mail processing operations in Saginaw, mail destinating in Saginaw is regularly being delayed, and service standards are being violated.

Williamsport, Pennsylvania

44. As a result of the closure of the Williamsport, Pennsylvania, destinating mail processing operation in 2013, a change which was not scheduled to occur until 2014 under the Network Consolidation Plan, mail is being delayed and is being delivered in violation of service standards in the Williamsport area.

45. A weekly magazine called Sports Illustrated is being delivered five days late.

46. Wall Street Journals were delivered 36 hours late for more than a month.

47. Numerous complaints have been received from small businesses about delayed

payments from customers in the Williamsport community.

48. As a result of the late arrival of trucks carrying processed mail, letter carriers are delayed and regularly must deliver mail until after 8 p.m. As a result, postal patrons receive their mail hours later than they did before the consolidation. In the case of small businesses, mail that should have been received during the business day is not received until the next business day.

Salem, Oregon

49. As a result of a consolidation that was scheduled for 2014 being carried out in 2013, mail is being delayed in the Salem, Oregon, area, and service standards are not being met. For example, a test mailing of a First Class Mail parcel sent certified mail was due to be delivered on June 22, 2013, under applicable service standards. It was not received until June 24, 2013.

50. Mailers complaining of delayed mail in Salem include Doneth Wealth Management, First Pacific Corporation, the Oregon Department of Motor Vehicles, and the U.S. Department of Justice. Complaints have included delays in First-Class Mail and parcel mail.

51. Because of the consolidation, collection times from postal mail boxes have been moved to earlier times throughout the area, and dispatch times from coastal Oregon are as early as 1:30 p.m. Mail deposited after earlier collection times or arriving at a facility after an earlier dispatch time is delayed by one full day in addition to mail processing delays caused by the consolidation.

LaCrosse, Wisconsin

52. As a result of a mail processing consolidation that had been scheduled to be done in 2014, mail in the LaCrosse, Wisconsin, area is being delayed. For example, the Vernon County Broadcaster, a weekly newspaper, reports that many of its newspapers are not being received until days or even a week late as a result of mail being transported to Minnesota for processing.

Carbondale, Illinois

53. The Carbondale, Illinois, mail processing center recently shut down and now its mail is sent to St. Louis, Missouri, for processing.

54. An official Postal Service announcement about this change stated that the fact that the mail is now being processed in St. Louis "may add a day or two to the normal delivery timeframe."

55. If the postal spokesperson quoted in the paragraph above is correct, the Postal Service is violating delivery standards in the Carbondale area due to the elimination of mail processing in Carbondale.

Cape Girardeau, Missouri

56. Mail delivered to Cape Girardeau, Missouri and the surrounding area is first processed in St. Louis, but it is regularly delayed by nearly three and a half hours before it is delivered to the Cape Girardeau P&DC for sorting. The St. Louis processing center is overwhelmed by the volume of mail, resulting in large delays and service standards not being met.

57. These delays have actual and, in some instances, detrimental consequences in Cape Girardeau and the rural communities around it. Residents in Cape Girardeau are

receiving newspapers two days after their publication, while residents in nearby Gideon, Missouri, have received water shut-off notices in the mail two days after their water was shut off.

Service Adversely Affected on a Nationwide or Substantially Nationwide Basis

58. Altogether, the Postal Service has decided to close down 55 mail processing operations in 2013 that had been originally scheduled to be included in Phase II of its Network Consolidation Plan in 2014.

59. Approximately 90 facilities were scheduled for closure in 2014 instead of in 2013 for two reasons: (1) Closure of these facilities would require elimination of one-day First-Class Mail service within SCFs for individuals and small businesses, and correspondingly slower service for all other types of mail; and (2) The service standard changes necessary to permit the slower delivery standards are not scheduled to take effect until February 1, 2014.

60. The decision to close 53 or 55 of the mail processing operations in 2013, that were originally scheduled for closure in 2014, was made by the Board of Governors or by postal management despite the likelihood that mail would be delayed in violation of applicable service standards.

61. Despite postal management's best efforts, it has been impossible and will remain impossible for the Postal Service to meet its delivery standards in areas where 2014 closures have been carried out in 2013.

REQUEST FOR RELIEF

For the reasons stated above, the APWU respectfully requests that the Commission:

A. Hold that the Postal Service has violated its Service Standard Regulations as described in the Complaint above;

B. Hold that the Postal Service has violated Section 403(c) of the Act by making undue and unreasonable discrimination among users of the mails, specifically individuals, small businesses, and organizations, including the APWU and its locals;

C. Hold that the Postal Service has violated Section 3661(a) and (b) of the Act by changing to a generally less adequate and effective nationwide system without seeking an advisory opinion from the Postal Regulatory Commission;

D. Order the Postal Service to take necessary steps to come promptly into compliance with its Service Standard regulations;

E. Order the Postal Service to cease and desist from making changes in its mail processing network that will cause it to violate service standards; and

F. Order the Postal Service to provide the APWU and its locals an appropriate remedy for any adverse impact on them due to the delay of their mail.

Respectfully submitted,

/S/
Darryl J. Anderson
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Counsel for Complainant
American Postal Workers Union, AFL-CIO

September 5, 2013

CERTIFICATIONS REQUIRED BY RULE 3030.10(9) and (10)

I hereby certify that a copy of this complaint is being simultaneously served on the Postal Service at PRCCOMPLAINTS@usps.gov in accordance with Rule 3030.11.

I hereby certify that counsel for the APWU conferred with the Postal Service's general counsel in an attempt to resolve or settle this complaint, and that, despite good faith consideration by both parties, additional efforts to settle or resolve this complaint would be unsuccessful at this time.

/S/

Darryl J. Anderson
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Counsel for Complainant
American Postal Workers Union, AFL-CIO

September 5, 2013

NATIONAL RURAL LETTER CARRIERS' ASSOCIATION

1630 Duke Street, 4th Floor Alexandria, VA 22314-3465 Phone: (703) 684-5545

Written Statement of
Jeanette Dwyer, President
National Rural Letter Carriers' Association

Before the

Senate Homeland Security and Governmental Affairs Committee

September 19, 2013

Chairman Carper and members of the Senate Homeland Security and Governmental Affairs Committee, my name is Jeanette Dwyer, and I am President of the National Rural Letter Carriers' Association (NRLCA). Our union represents over 101,000 bargaining unit employees who proudly deliver mail for the United States Postal Service. We are often called a "post office on wheels" because we do more than simply deliver mail to homes and businesses. On our routes, we sell stamps and money orders, accept express and priority mail, offer signature and delivery confirmation, registered and certified mail, and, of course, collect our customers' parcels. Our Craft epitomizes the concept of "universal service" by providing these services in rural, suburban, and urban areas throughout the United States, including places that the Postal Service's competitors do not go.

Currently, rural letter carriers serve approximately 73,000 routes across the United States. We drive more than 3.5 million miles per day, delivering to over 40 million boxes. The average mileage for a rural route is more than 48 miles, with the longest route stretching over 170 miles.

The NRLCA and its members care deeply for the Postal Service and the service that it provides to Americans, and we are greatly concerned about the apparent direction that it may be heading under this and other proposed legislation.

The NRLCA has numerous concerns with the Senate postal reform legislation that was recently introduced. Some of these concerns are included in our written testimony, but it was requested that I specifically address the areas of rates, innovation, and service.

During the debate and subsequent passage of the Postal Accountability and Enhancement Act, Public Law 109-435, the NRLCA supported the effort to tie postage rate increases to the Consumer Price Index. The NRLCA supported the effort as a means to pass postal reform legislation, but also as a way to give the mailing industry some degree of certainty and predictability to prepare their budgets. Unfortunately, given the unforeseen economic crisis, the use of the CPI Index has limited the revenue the Postal Service can raise. The Great Recession caused the Postal Service not to conduct the one-time, final omnibus rate case called for in the PAEA, as the Postal Service rightly did not want to raise rates in the midst of a recession. Given these circumstances, at the very least, the Postal Service should now be permitted to adjust its rates with a one-time postage rate review and adjustment that PAEA originally authorized to occur in 2007.

However, any legislation must maintain some form of price cap to ensure that customers continue to use the Postal Service to deliver their products. Therefore, we oppose any provisions in S. 1486 that would eliminate the pricing index. Such a provision will create uncertainty for the mailers when budgeting for future fiscal years and result in a loss of mail through the system, and more importantly, customers.

Furthermore, innovation is essential to the Postal Service's survival. The Postal Service must continue to offer new services and products, as well as upgrade current services to continue to compete and survive in the market economy. I believe the creation of a Chief Innovation Officer will go a long way to ensuring that the Postal Service remains competitive.

The Rural Reach program represents one innovative approach that the Postal Service has already successfully utilized to generate new business and revenue. This program puts the power and the opportunity to build the business in the hands of the people who care the most about the Postal Service: its employees. Through the Rural Reach program, tens of thousands of rural letter carriers actively solicit businesses who they see using competitors while delivering their route. Since its inception, Rural Reach has generated more than $351.2 million in new business for the USPS.

S. 1486 authorizes the Postal Service to deliver wine, beer, and distilled spirits from producers who are permitted through their state laws to ship alcoholic products. This would change a pre-Prohibition Law that has restricted the Postal Service from entering into significant revenue generating areas. Antiquated laws such as this have constrained the Postal Service's ability to engage in endeavors that would result in new revenue.

The NRLCA supports provisions in the Senate bill allowing the Postal Service to offer non-postal products, as well as offer services on behalf of federal, state, local, and tribal governmental agencies. The postal reform bill in the House unnecessarily limits new revenue generation to selling advertising space on vehicles and facilities, as well as offering state and local services. Whatever compromise is worked out between the two bills, I believe the language should have as few restrictions as possible.

The local post office has the potential to once again become the "town hub," a destination where citizens meet and socialize. Although this idea has been presented many times, Congress should allow the Postal Service to offer fishing and hunting licenses along with the passport services already offered. The Postal Service can also bridge the digital divide between many rural areas and their urban counterparts. According to the Federal Communications Commission (FCC), only 93.8% of rural residents have basic internet access compared to 99.4% of their urban counterparts[1]. Kiosks can be placed in post offices, essentially an E-Government service where the post office becomes an extension of the government, where citizens can have their social security, welfare, healthcare, and other questions answered.

The Postal Service possesses a vast, unique network, reaching into every state, district, city, town, and county. This can be, and must be, utilized to the Postal Service's advantage.

Finally, I would like to discuss service. Make no mistake; we need to keep the service in Postal *Service*. This means continuing to provide 6 day-mail delivery, keeping post offices and processing facilities open, and maintaining current service standards; and we believe all of this work should be done by federal postal employees.

The Postal Service needs to continue to build on its strengths of first mile and last mile service. Any cut or reduction will result in less service, which equals less mail, which equals the beginning of the end of the Postal Service.

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[1] The FCC defines "basic service" as 1-2 megabits per second. This is an acceptable usage amount for a single person on a single device with the most basic email and web surfing usage. A family of 4 would require "moderate service" (at 6-15 mbps) to have a minimal online presence. This level of service is unavailable to nearly 20% of rural Americans.

The Postal Service has proven that it can make money doing what it was intended to do from the start: process and deliver mail. The Postal Service has undertaken many cost-cutting measures, including reducing the number of employees to roughly 500,000; the lowest number of career employees in decades. In addition, the NRLCA and the other postal unions have made significant sacrifices in collective bargaining. The contract the NRLCA and the Postal Service recently negotiated is expected to save the Postal Service hundreds of millions of dollars over the life of the contract.

The Postal Service is in much better financial position than many people think. It is no secret that the most significant restraint on the Postal Service's success remains the congressionally mandated pre-funding of retiree health benefits. The Postal Service's FY 2013 third-quarter would have shown a $660 million profit had the Retiree Health Benefits pre-funding been excluded. The Postal Service should also show a year-to-date profit of $330 million profit, excluding the pre-funding payment. This is a remarkable achievement considering that the nation is experiencing a slow economic recovery from the largest economic downturn since the Great Depression. I believe the fact that the Postal Service can make a profit doing what it was created to do is evidence of the potential for a strong business model.

Instead, S. 1486 attempts to break this business model. It slashes service, cuts delivery days, closes post offices and postal facilities, interferes with collective bargaining, and reduces employee benefits all in the name of maintaining a pre-funding schedule; a pre-funding schedule that for the last six years has represented roughly 80% of the Postal Service's total losses.

Senators, you have the power to rectify this injustice. Reducing mail delivery days to five or fewer days, cutting service standards to eliminate overnight mail delivery, closings post offices and facilities will destroy the Postal Service -- not save it.

Mr. Chairman, the Postal Service is already experiencing the negative impacts of its decisions. The transportation, sortation, and delivery of mail has slowed. This is a direct result of the Postal Service's decisions to close processing facilities. Currently, it has closed too many facilities, and the facilities that remain open are experiencing a difficult time keeping up with current volume. If the Postal Service experiences even a small increase in mail volume, as many believe they will, delivery time will be impacted. Simply put, the Postal Service is struggling to handle the amount of mail volume they have now.

Many states are already experiencing slower process and delivery times because of the consolidation of facilities. This is resulting in rural letter carriers getting their mail late and customers getting their mail after dark. Frankly, this becomes a safety issue for the rural letter carrier, and a convenience issue for the customer.

The issue is the Postal Service has moved dispatch times, sometimes as early as 1PM. The normal dispatch time was 5PM, which allowed a rural letter carrier to complete their route, and return to the post office to drop off any letters or packages they had collected. Now that dispatch times have changed, many rural letter carriers are missing the dispatch times, resulting in mail and packages sitting over night before being collected and shipped to the processing plant. Even blue collection box times have changed, further inconveniencing customers. Some states experiencing this problem are Missouri, Minnesota, Wisconsin, North Dakota and

Louisiana. The closures and consolidation the Postal Service has initiated have made it almost impossible to efficiently handle the mail volume that is coming through the system.

The NRLCA strongly believes S. 1486 will inadvertently cause the Postal Service and abandon those Americans who most rely upon the regular delivery of the mail. The Postal Service is a *service.* You cannot expect to cut and get more. Shipping and package delivery revenue continues to increase dramatically. This is a result of an exploding e-commerce sector that is helping to mitigate the negative impacts of online communication and bill pay.

And then there are the jobs. At a time when unemployment hovers at 7.3%, this is no time for massive layoffs that will inevitably occur with the elimination of 6 day mail delivery. The pending legislation will result in the significant loss of good, middle-class jobs. Job losses in the rural craft alone could reach upwards of 50,000 depending on the availability of work and the number of days the Postal Service delivers mail. The jobs that the Postal Service is planning to eliminate are good middle class jobs that will affect mainly minorities, women, and veterans.

I must also point out the severe hardships that would be visited on rural America if our customers and small businesses lose a day to send and receive mail. Their livelihoods, and often their health, depend on the Postal Service for their communication and delivery needs. There are no alternatives in many communities.

We cannot afford to move backwards. We must continue to provide the service our customers expect and have come to rely upon. To do otherwise would add insult to injury and further undermine the financial wellbeing of the Postal Service, which we desperately want to succeed.

The potential to succeed is there if the Postal Service focuses on growing its business, not shrinking it by reducing delivery frequency. Package delivery, for example, is a growing market for the USPS, led by the increase in e-commerce. The Postal Service can find ways to utilize its unique, universal delivery network to remain competitive. For example, the Postal Service is testing same-day delivery with Amazon for online orders. It is innovative ideas and partnerships such as these that will strengthen the Postal Service.

Finally, I would be remiss if I did not say something about health benefits. The Senate bill allows for the Postal Service and its unions to bargain over the creation of a new health plan, either within or outside of FEHBP. Let me be clear about this; the NRLCA will not support any proposal of a Postal-only health plan that leaves FEHB. Leaving FEHB will undoubtedly mean reduced benefits and increased costs for employees and retirees. The negotiating and purchasing power of the FEHB is unparalleled, and there is a reason that there is no successful precedent for federal agencies abandoning the FEHB.

Other efforts to leave FEHB have failed. The Federal Deposit Insurance Corporation (FDIC) withdrew from the FEHB in 1982, claiming that a third party administrator would reduce expenses. By 1997, the FDIC concluded that it was no longer cost-effective to provide health insurance as a self-insured entity and that the FEHB was better positioned to bargain for lower premiums and better benefits. It rejoined the FEHB, only after acquiring Congressional legislation which allowed the return to the FEHB at an estimated cost of $170 million to the FDIC's approximately 5,700 employees. It truly was a failed experiment. The fact is that the Postal Service simply cannot compete – even if it had the health insurance experience – with the FEHB. Moreover, we have no interest in putting retiree health benefits at risk each and every time we negotiate over health benefit contribution levels.

Our FEHB Plan, the Rural Carrier Benefit Plan, has been part of the FEHB Program since its inception. The Plan is well managed, includes all of the medical and prescription cost management programs contemplated in a separate Postal-only plan, and has excellent reserves to weather any financial crisis. The Plan provides comprehensive coverage at a very competitive premium rate and is annually recognized as one of the best health plans for customer satisfaction and for benefits coverage by our Plan members and the US Office of Personnel Management (OPM).

Mr. Chairman, and members of the Homeland Security and Governmental Affairs Committee, I know the economy is causing great uncertainty, and solutions must be found to keep the Postal Service moving forward. However, you have the power now to relieve the Postal Service of a huge financial obligation by relieving the Postal Service of its unfair pre-funding mandates and returning the FERS pension funds that rightfully belong to the Postal Service. By doing so, you will give the Postal Service a fighting chance to remain viable without having to take drastic measures that will only harm this great institution, the Americans who rely upon it, and the employees, such as rural letter carriers, who serve it with determination, integrity, and pride.

Thank you for allowing me to submit testimony, and I would be happy to answer any questions.

STATEMENT OF JOHN BEEDER,
PRESIDENT AND CHIEF OPERATING OFFICER,
AMERICAN GREETINGS, CLEVELAND, OHIO,
BEFORE THE
COMMITTEE ON HOMELAND SECURITY
AND GOVERNMENTAL AFFAIRS,
UNITED STATES SENATE

September 19, 2013

I am John Beeder, President and Chief Operating Officer of American Greetings, in Cleveland, Ohio. I am speaking today on behalf of the Greeting Card Association, which comprises more than 150 publishers of greeting cards and related social stationery products throughout the United States. The GCA has long been a strategic partner of the United States Postal Service, since some 60 percent of all greeting cards sold are mailed. We have a proud history of representing the household mail user on many different issues before policymakers, regulators, and the public. We are grateful for the opportunity to participate in today's hearing.

S. 1486 contains many desirable reforms and initiatives, which we and the mailing industry generally can support. As Senators may be aware, the GCA released a report earlier this summer which set out more than 100 cost-saving options for the Postal Service, drawn from GAO and Postal Service Inspector General studies. A copy is appended to my testimony. We are pleased to see that two of these commonsense recommendations – a shift to more cost-effective modes of delivery and a realistic treatment of retiree health benefit funding – are prominent features of S. 1486.

The current bill's proposals for streamlining the Postal Service and enabling it to continue providing top-quality service at less cost are, for the most part, well chosen and clearly laid out. It would put an end to the long-standing statutory floor under fringe benefits, enable the Service to operate its own health benefits plan, make the labor arbitration process somewhat more realistic, reform workers' compensation, and promote exploitation of more economical delivery modes. While the overall thrust of the bill is properly toward a leaner, more efficient Postal Service, some provisions meant to produce cost savings are unlikely to be effective and will only exacerbate the problem. Principally, I am referring to the authorization to reduce delivery days – not just to five per week, but possibly to even fewer. We believe this could cost the Service too much in lost revenue and lost economies of scale and scope from lost volume for the claimed cost savings to be worthwhile even if they were achieved.

A principal focus of today's hearing, and of my statement, is the ratemaking provisions of S. 1486. For that reason, my testimony will sound rather more negative than it would if I were discussing the bill as a whole. These ratemaking provisions are a matter of grave concern. The bill would be much improved by simply striking section 301, and leaving the current PAEA ratemaking provisions in place. These were passed by Congress after a decade of careful debate and compromise, and have been developed over the years since 2006 by the Postal Regulatory Commission (PRC). That system may not be perfect, but at least it provides an independent view of rate issues, a meaningful incentive for the Postal Service to reduce costs, and a sufficient escape hatch in the form of a PRC-directed exigency increase procedure, while still achieving the original objective of significantly streamlining the expensive and cumbersome ten-month litigation process created in the early 1970s.

The bill's abolition of PAEA's safeguards seems to rest, fundamentally, on the mistaken premise that the Postal Service's financial problems are somehow due to the ratemaking system and insufficient revenue. They are not. The Postal Service today has a cost problem, not a ratemaking or revenue problem.

The Service's cost problem is admittedly not entirely under its direct control. If the unworkable PAEA retiree health care prefunding schedule were appropriately redesigned, as section 103 of the bill sets out to do, a very large part of the Service's current deficit problem would evaporate as the PRC, mailers, unions and others have stated.. The Service can, of course, take its own steps to reduce its costs, with Congress's help where needed. As the GCA's report showed, the Service's financial woes, while serious, could be largely solved by adopting recommendations already made by GAO and the OIG – all without raising rates or cutting essential services. Thus there is no reason to encourage it to drive away customers and reduce its own revenue by eviscerating the ratemaking system, as S. 1486 would do.

Hardly any mail user today is without alternatives. Package mailers and some periodical publishers can use private-sector carriers. Businesses and households can, and increasingly do, manage their transactions on-line. While no one doubts the impressive effectiveness of direct mail advertising, even those customers have an array of other media to choose from. The notion that the Postal Service still has a reliable monopoly in the real-world market (I am not referring to the Private Express Statutes) is simply obsolete. It is odd indeed, then, that the ratemaking provisions in section 301 of S. 1486 would make structural changes moving the Postal Service in the direction of an unregulated monopoly with all of the power but none of the responsibility such an entity should have.

Overall, the bill properly focuses on helping the Postal Service become leaner and more efficient. Why weaken these incentives by eliminating any independent voice – and, after 2016, eliminating any price cap, and thus any control at all – on postal prices? If the anti-regulation provisions of S. 1486 were stricken, the resulting bill would have a clear and well justified focus on greater efficiency. With those provisions left in, it is structurally incoherent and self-defeating. The incentives to resort to rate increases, inherent in those provisions, undermine the pro-efficiency thrust of the rest of the bill.

The existing PAEA price cap is certainly a generous one compared to many other regulated sectors. Legislators commonly set utility price caps as "CPI minus X" whereby the CPI is reduced by a set percentage "X" for productivity growth in order to encourage cost reductions by the firm. The PAEA price cap has no such X factor. The bill, however, would do away with PAEA's relatively liberal price-cap incentive to efficiency after 2016. This makes no sense, either on its own footing or in the context of other important features of S. 1486. With neither a close tie between rates and costs, as existed under the 1970 Postal Reorganization Act, nor an exogenous price cap limiting increases under PAEA, there would be nothing in the statute to forestall resorting to regular rate hikes above the CPI as a way of "avoiding the unavoidable": the need to control costs and realign the system to make it fit 21st Century mail usage patterns.

Even before the proposed abolition of the price cap, S. 1486 would weaken existing regulations unnecessarily. Today, there is an independent evaluation by the PRC of whether each new set of rates conforms to the price cap. There is no good reason to take this function from the PRC and hand it over to the same Board of Governors which would direct the filing of the rates in the first place under the bill. It would put the Board in the untenable position of having a conflict of roles: "independently" verifying its own actions. Abolishing independent review would be a serious loss to all mailers and the public, and an abrogation of the fundamental obligation to fairness inherent in a government-sponsored enterprise. S. 1486 rightly attempts to retain that obligation in the ratemaking objectives; but ultimately these are undermined by abolishing independent examination of rates.

Another serious flaw in section 301 of the bill is its treatment of exigency rate cases. One might believe – we do not – that assessing price-cap compliance is a purely mechanical process where there is no real need for an independent evaluator. But that is clearly not true of exigency cases, where at least four legal standards, all having the potential to be controversial, must be met. The evaluator must find (i) that exceptional or extraordinary circumstances are present, and then that the increase is (ii) reasonable, (iii) equitable, and (iv) necessary under "best practices of honest, efficient, and economical management." Section 301 of S.1486 would have the Board of Governors decide these four difficult questions. In other words, the same Board which is responsible for managing the Postal Service would be charged with deciding, in an exigency case, whether it and the executives it has hired have managed it honestly, efficiently, and economically. This is another obvious conflict of functions, and would allow the Postal Service to act as an unregulated monopolist in the prices it charges for market dominant products. In the private sector, the directors of a regulated utility would never be charged with deciding whether the company they manage was legally entitled to a rate increase.

The section also overlooks the practical inability of a part-time Board with limited independent legal or economic expertise to challenge recommendations by Postal Service management. The Board as currently composed lacks both time and readily available independent expertise to examine rate and service proposals critically and in detail. The greater likelihood would be that there would be no effective system of checks and balances to ensure that management does not err.

These problems with the bill cannot be solved by allowing rate decisions to be reviewed by the PRC on complaint. The complaint procedure places the burden of proof on the complainant. Injured mailers would be hard pressed to meet the considerable expense of proving such a case, and S. 1486 would take away any guarantee that the information they would need to prove their case would be available.

One of the important objectives of PAEA, written into section 3622(b), was to increase the transparency of the ratemaking process. S. 1486 repeals that objective. The Board of Governors would decide rate questions through a form of notice and comment procedure with, apparently, no obligation to describe or disclose all the data and assumptions on which they relied. Potentially, therefore, the Board could choose to render its decisions largely complaint-proof. Even assuming these problems away, it would remain true that while the would-be complainants assembled their case and shepherded it through the PRC's complaint process, they would be paying questionable and perhaps provably unjustified rates. With no practical mechanism to provide relief where it is due, the strong likelihood is that rather than filing a complaint with a heavy procedural burden and possibly no way to obtain necessary data, potential complainants would instead switch more of their communications to alternative carriers or to electronic media. Simply put, these section 301 provisions of S. 1486 would very likely accelerate the decline of postal volumes precisely on account of the new and largely unchecked ratemaking power of the Board of Governors.

There is one other feature of the bill, not centrally concerned with ratemaking, on which I would like to offer a comment. This is section 206, which does away with the PRC's advisory opinion role in connection with significant, nationwide service changes. First, abolishing any independent pre-implementation review would be a serious loss – not just to users of the mails but also to Congress itself. The PRC's advisory opinions have provided a well-informed, objective view of these changes, some of which are arguably not just operational decisions properly left to the Postal Service, but rather fundamental definitions of the level and quality of service that should be of concern to the Congress. It is especially disturbing that section 206 appears to contemplate rate and classification changes along with, or as part of, a service change. As some proceedings at the Commission have demonstrated, it is hard enough to estimate the effects on volume and revenue of a service change unaccompanied by changes in rates. The two sets of changes combined could make a difficult analysis almost unmanageable.

The PRC's advisory opinion on the proposed reduction of carrier delivery and pickup to five days shows clearly how important an independent view of service changes can be. Congress has engaged in a serious reconsideration of this scheme, and the PRC opinion has been a valuable resource. In this connection, GCA is disappointed that S. 1486 seriously weakens the sensible compromise reached in the 112th Congress. Section 207 of S. 1789 appropriately required a two-year waiting period and a determination, subject to review by the GAO and the PRC, that other prescribed cost-saving measures did not obviate the need to cut service in order to achieve long-term solvency. These necessary safeguards are diluted or omitted altogether in S. 1486.

To summarize our views on the regulatory provisions of S. 1486: the ratemaking and service change provisions should be stricken from the bill. We also urge that the Committee, at a minimum, restore the approach to consideration of reducing delivery frequency included in the bill passed in the Senate last year. Striking these two provisions and reverting to an approach on delivery frequency that garnered sufficient support for passage would be the simplest and cleanest way to restore the bill's commendable focus on creating a streamlined, cost-efficient, and capable Postal Service for today's needs. Encouraging a short-sighted approach to financial problems that would facilitate potentially large rate increases needlessly undermines the beneficial features of the bill, and eliminating independent review of important decisions is not in the interest of mail users, the Congress, or, in the long run, the Postal Service itself.

Appendix

A Commonsense Solution for a Stronger Postal Service

The Greeting Card Association

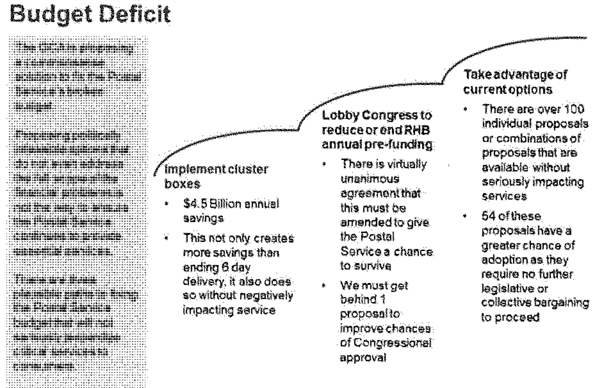
July, 2013

Executive Summary

The Greeting Card Association's (GCA) commonsense solution puts the United States Postal Service (USPS) on a path to solvency without cutting critical services or raising rates. There are more than 100 deficit reduction proposals provided by past U.S. Government Accountability Office (GAO) and Office of the Inspector General (OIG) reports that offer numerous combinations for ending the total structural deficit of the Postal Service. Using these, the GCA shows that the total Postal Service budget deficit can be fixed in three steps:

- **First**, the Postal Service should immediately implement cluster boxes on a widespread national scale using its existing management authority to do so, and drop politically divisive plans for Congress to end Saturday mail delivery;
- **Second**, the Postal Service should work with Congress to achieve a solution to the Retiree Health Benefits system (RHB) prefunding issue by amending the Postal Accountability and Enhancement Act (PAEA) and get this stand-alone legislation passed before the August recess;
- **Third**, the Postal Service should evaluate the impact of the first two steps during the rest of this year and if more deficit reductions are needed, it should first draw from the list of 53 remaining proposals herein that it can implement under its existing management authority.

GCA's Three-Step Plan To Solve Postal Service Budget Deficit



Cutting services is not the commonsense solution when there are so many other options available. The GCA has had a longstanding policy position that the best way to solve the Postal Service's structural deficit and return it to solvency is to identify proposals that maintain universal service at affordable prices for every citizen throughout the country.

This analysis demonstrates that cutting essential services such as Saturday delivery is not necessary to fix the Postal Service's budget deficit. There are more than 100 deficit reduction alternatives from recent GAO and Postal Service OIG reports that can replace ending Saturday delivery, either alone or in combination. None raises rates or cuts service. 54 of these proposals would not require any collective bargaining or legislation by Congress.

Rate increases will only add to the problem. Rate increases are counter-productive and will only add to the structural deficit faced by the Postal Service by driving even more postal volume away to competing products and services. Even a relatively modest rate increase would drive one billion pieces of single piece letter mail out of the system.

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Appendix 7: Forty-Four Proposals Requiring Collective Bargaining Or Legislation

I. Introduction: The Postal Service's Structural Deficit Is Smaller Than It Contends

On April 10, 2013, the U. S. Postal Service Board of Governors (BOG) issued a press release directing the Postal Service to "delay implementation of its new delivery schedule" – *i.e.* no Saturday delivery except for packages – beyond its planned August 5, 2013 date and until Congress has enacted a postal reform bill, including a "financially appropriate and responsible delivery schedule." In the interim, it directs postal management to "seek a reopening of negotiations with the postal unions" and to look at other options, "including an exigent rate increase."

The BOG states that a "new national delivery schedule" (that is, ending Saturday delivery of mail) "is a necessary part of a larger five-year business plan to restore the Postal Service to long-term financial stability." It references an "ever widening budgetary gap."[1] It then asserts that: "It is not possible for the Postal Service to meet significant cost reduction goals without changing its delivery schedule – any rational analysis of our current financial condition and business options leads to this conclusion." This paper challenges these assertions and outlines numerous commonsense solutions that achieve our mutual goal of a viable Postal Service.

This paper presents numerous deficit reduction options to reduce costs or expand revenue without raising rates. These options have been set forth by the Postal Service's own Office of the Inspector General (OIG), and the General Accountability Office (GAO). There are numerous combinations of opportunities for solving the Postal Service's deficit problem. Even if we eliminate options that are in the implementation process and those that are not politically feasible, there is still a very long list of options that would effectively solve the Postal Service's budget deficit. There is an even larger list that would replace any savings lost from retaining six day delivery.

The perceived need to end Saturday delivery for any mail product (or overnight delivery of First Class single piece letters) depends on the true size of the Postal Service's deficit problem. Since March 2010, the Postal Service has employed a public relations strategy of overstating long-run deficit forecasts to pressure Congress to enact postal reform legislation. In part this has been achieved by projecting a baseline deficit through 2020. The strategy has failed to produce legislative results. Yet, the Postal Service continues to operate: collecting, processing and delivering mail Monday through Saturday.

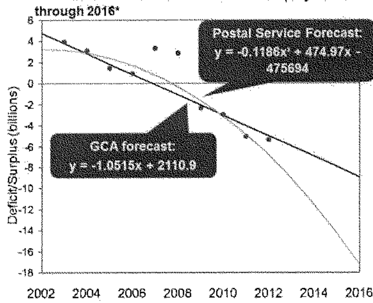
Since the Postal Service first launched its deficit campaign with a briefing on three consultant reports in March 2010, the solution to the Postal Service's operating deficits has become a moving target of varied long-run forecasts with statistically measureable upward biases. This is not entirely the Postal Service's fault given Congress' failure to act on any one set of proposals. However, for at least a year now the Postal Service has not presented Congress or the mailing community with coherent data in favor of securing any form of savings. Because credible data has not been presented, politically unfeasible cuts like Saturday mail delivery are always on its deficit reduction list.

Ending Saturday delivery has been a long-term goal of the Postal Service's management even before there was a deficit problem. Therefore, no matter what the actual size of the deficit forecasts, cutting Saturday delivery is always on the list. Unfortunately, it appears eliminating Saturday delivery would remain a top policy goal even if the Postal Service were running an operating surplus, despite lack of credible data showing it is a true necessity or effective solution.

Is the long run Postal Service deficit gap growing by as much as the Postal Service claims? Net of the RHB prefunding obligation, recent operating deficits were:
-$2.4 billion, FY 2009; -$3 billion, 2010; -$5.1 billion, 2011; and -$5.4 billion, 2012. From this baseline the Postal Service forecast "grows" its annual operating deficit by about -$3 billion each year through 2016, to -$15.5 billion.
There is little justification for the assumptions leading to a $10 billion increase in the annual operating deficit by 2016 from the 2012 actual deficit of -

Budgetary Statistical Analysis

Statistical tests of Postal Service deficit projection through 2016*



*From USPS Five Year Plan, February 2012

The GCA forecast has a stronger statistical result with a Fisher F-Value of 29.18 compared to an F-value of 19.63 from the Postal Service forecast.

The P-value is also significantly lower than the Postal Service projection.

$5.4 billion before RHB prefunding is factored into the equation. In essence, this forecast, as well as the earlier one from March 2010, presumes Postal Service management is unable to negotiate better labor contracts with its four major unions, even under dire financial conditions. A more plausible baseline forecast is that the operating deficit (apart from RHB funding) will ratchet up by at most $2 billion annually through 2016 rather than $3 billion. This would put the total operating deficit at -$12.5 billion.

A $1 billion annual increase would put the annual baseline deficit at -$9.5 billion at the end of FY2016. Statistical tests show a linear forecast model projecting a $9.5 billion deficit in 2016 performs better than the Postal Service's forecast of $15.5 billion. The graph above depicts a quadratic equation that best fits the Postal Service's latest forecast through FY2016.

Appendix 1 indicates both forecasting equations have R-squared measures of "best fit" around 0.8, and are statistically the same. A perfect fit would be a regression with an R-squared value of 1.0, meaning the forecast is completely explained by the trend of past data. In comparing the two regression models to see which has the best fit to the population sampled, however, the linear model has a Fisher F – value of 29.18, which is a superior statistical result to the lower F – value of 19.63 in the non-linear model best fitting the Postal Service's forecast. The associated probability P – value for the linear regression (0.000644), is a significantly lower number below the 5% significance level than that for the quadratic regression fitting the Postal Service forecast (0.001347).[2]

Including RHB prefunding, a more reasonable estimate of the 2016 total deficit baseline (before cuts) would be $15.3 billion to $18.3 billion. The Postal Service has apparently sought to make its -$21.3 billion total deficit in 2016 a more plausible number by claiming its actual 2012 deficit was $16.5 billion. Normal accounting practices would put the total 2012 deficit at $11.5 billion because it would not engage in double counting of the annual RHB prefunding.[3]

The third problem with the Postal Service deficit forecasts relates to savings from initiatives that have already been successfully implemented such as network consolidation and post office closings.[4] The Postal Service has already achieved about one-half of its anticipated $4.1 billion from plant closings and transportation savings. On this account alone the baseline deficit for 2016 should be reduced from $22.5 billion to $20.5 billion and its current need for annual deficit reduction by 2016 reduced accordingly.

Solutions That Will Not Cut Critical Services Or Raise Rates

	Proposal Scenarios	Examples of Cost Savings
109 Distinct Proposals For Deficit Reduction	**54 Proposals Require No Further Legislation Nor Collective Bargaining** between USPS management and its labor unions before implementation	• Early retirement incentives • Diverse stamp distribution • GPS system adoption
	78 Proposals Require No Collective Bargaining between the postal employees union and USPS management	• Early retirement incentives • Move retail to self-service • Reform leases
	59 Proposals Require No Further Legislation by Congress before implementation by USPS management	• Outsource custodial work • Close processing plants • Sell USPS real estate assets
	44 Proposals Require Either Additional Legislation Or Collective Bargaining between USPS management and its labor unions before implementation	• Reduce RHB prefunding • Two tiered wage system • Change retirement formula

In Sections II. through XI., we discuss 129 proposals for cutting Postal Service deficits without cutting Saturday mail delivery. A small number of these proposals originate from separate sources, yet have a high degree of overlap – 109 distinct proposals remain. A few of these are in process to a greater or lesser degree, and are noted by section. Many of the proposals are accompanied by annual savings estimates to the deficit, however some are not. The Postal Service, Congress, GAO and other agencies should be encouraged to provide savings estimates for these.

II. Deficit Reduction Proposals That Do Not Cut Critical Service To The Public Or Raise Rates Are Preferable

The Greeting Card Association (GCA) has had a longstanding policy position that the best way to solve the Postal Service's structural deficit and return it to solvency is to identify proposals that do not cut service either to mailers in general or to citizen mailers in particular. To the maximum degree possible, the deficit reduction lists that follow focus on proposals identified in recent General Accountability Office (GAO) or Postal Service Office of the Inspector General (OIG) reports that in GCA's opinion affect service minimally or not at all. Appendix 2 summarizes the impact of GCA's master list of 109 distinct deficit reduction proposals by the impact each one would have on service.

It should be stressed that of the 109 proposals, only 45 have annual savings listed or that can be inferred, while 84 do not have any savings listed. Most of the discussion that follows concentrates on those proposals for which annual savings are listed or estimated. It should be kept in mind, however, that the universe of deficit reduction options is nearly three times as large as the options on which the paper focuses. Those 84 proposals should be costed out by the agency originating the idea and evaluated before any notion of cutting service or raising rates is put forward.

The GCA has also had a longstanding policy position that rate increases, especially when the postal product concerned faces the essentially free competing alternative of the Internet and email products, are counter-productive and will only add to the structural deficit faced by the Postal Service by driving even more postal volume to competing products and services. Rate increases are not the only way of raising revenue, and in Section VII.,16 proposals for reducing the Postal Service deficit by raising revenue without raising rates are presented.

Rate increases will only add to the structural deficit faced by the Postal Service by driving even more post volume away to competing products and services.

III. The Most Plausible Paths For Postal Service Financial Viability Without Cutting Saturday Mail Delivery

A. Three Options That Stand Out

There are two clear-cut paths that would move the direction of the Postal Service a long way toward financial viability. One would eliminate the strong opposition in Congress to ending Saturday delivery by replacing that proposal with another approach to curbing delivery costs. The other path would enact one proposal that many feel is at the crux of the Postal Service's structural deficit, support for which is strong in both houses of Congress and both political parties.

The first path to success is that whatever the plausible size of the deficit problem, measured as the annual need for cuts as of the end of FY2016 from a 2012 baseline, OIG's proposal for widespread adoption of cluster boxes rather than address to address delivery supersedes the need for any reduction in current six day delivery standards. The GCA made this point in its 2011 report, using the consensus calculus of that time estimating the size of the deficit problem.[5] Unfortunately, some members of Congress, without any clear understanding of how much the Postal Service's deficit needs to be cut today, adopted the cluster box idea in addition to ending Saturday delivery. As outlined in Section I., the magnitude of the Postal Service's deficit problem does not require both cluster boxes and ending Saturday delivery, it requires choosing one or the other. The choice of cluster boxes would remove much political opposition to postal reform bills because they now include the highly unpopular choice of cutting Saturday delivery.

The second path to success in managing the Postal Service's deficit is to start by getting Congress to enact legislation ending or greatly curbing the RHB annual prefunding mandate. It is not unusual for laws as complex as PAEA to require modifications to the initial legislation as time and experience under the new law accumulate. This was true of the 1970 Postal Reorganization Act, which was significantly amended in 1976. More than any other single deficit reduction proposal, there is unanimous agreement from virtually all stakeholders that a radical overhaul, if not complete elimination of RHB prefunding, should be made.

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There is widespread political support for this proposal in both houses of Congress, across party lines, and at the Postal Regulatory Commission. Once such a bill is passed, alone or in conjunction with cluster boxes, the Postal Service's financial condition can be monitored quarterly, the effects of these deficit reduction initiatives evaluated, and a more measured approach to enacting any further deficit reduction proposals taken instead of acting in the unproductive crisis-mode atmosphere of the past three years.

A third path to success is to adopt other "top drawer" proposals from our list of more than 100 individual proposals or combinations of proposals which will solve the Postal Service's overall deficit problem without having to end Saturday delivery. Questions that should be asked include:

What options from our list fully cover the claimed cost savings from ending Saturday delivery?

What options constitute a total deficit reduction package that would restore financial viability to the Postal Service?

What combinations of options would be politically viable?

Of these, what are the best options?

The answer to the first question above depends in part on what the cost savings are from ending Saturday delivery. The Postal Service currently puts the cost savings as $2 billion annually for cutting Saturday mail delivery, but retaining Saturday delivery of packages and medicines. The PRC put the cost savings at $1.7 billion in its March 24, 2011 Advisory Opinion on Ending Saturday Delivery after analyzing the Postal Service's original $3.1 billion estimate for eliminating all Saturday delivery of letters, flats, and parcels.

The cost of modifying the Postal Service's original proposal was to add back $500 million to Saturday delivery costs for packages and medicines. The Postal Service has explained that it began with a savings estimate of $2.6 billion – less than that presented in the 2010 advisory opinion case at the Commission – because, owing to increases in operating efficiency and declines in volumes since FY2009, the FY2012 savings opportunity is smaller.[6] The range of savings possible from the current proposal are the Commission's $1.7 billion minus the add-back for Saturday package and medicine delivery, or $1.2 billion, rather than the Postal Service's current estimate of $2 billion. Potential volume losses from factors not considered in the advisory opinion process could drive the Postal Service's savings estimate even lower to as little as $600 million annually.

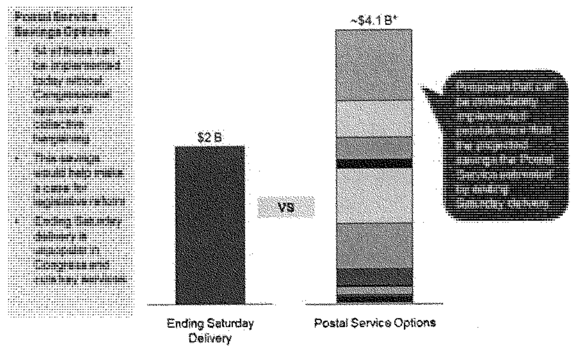
Two problems become evident when considering any top-drawer proposals or combinations thereof compared to the first two strategic paths toward success. What is the political feasibility of each? Support for any of these cannot be measured vis-a-vis the widespread support for overhauling RHB prefunding as established in PAEA. Nor can opposition to any of these be measured vis-a-vis the strong opposition in Congress to ending Saturday delivery. If we consider a much broader list of deficit reduction possibilities such as all 109 non-duplicative proposals, these same two problems loom even larger.

One way of reducing the uncertainty and showing a third path toward success is to classify each proposal in the following way. Of paramount importance is to identify proposals that would not require legislation by Congress or collective bargaining. From the Postal Service's perspective, these are proposals which management should be able to accomplish on its own. This list would be the most politically feasible set of alternatives to ending Saturday delivery given the Postal Service's relatively weak record when it comes to collective bargaining and lack of success the past three years in getting a deficit reduction bill through Congress.

B. Fifty- Four Deficit Reduction Proposals The Postal Service Can Accomplish On Its Own

Recently, the Postal Service's Board of Governors has stated that Congress must pass a postal reform bill that includes cutting Saturday delivery for its structural deficit to be trimmed any further.[7] This is not a correct statement. Appendix 4 lists 54 deficit reduction proposals from the master list of 109 non-duplicative proposals that do not require collective bargaining between Postal Service management and its labor unions and do not require legislation getting passed before the Postal Service can implement the proposal.

Immediate Cost Savings Outweigh Ending Saturday Delivery



*Lump sum cost savings amortized over 5 years

Of these, the known savings for eighteen total over $3.5 billion in annual savings, excluding savings from selling real estate assets ($85 billion), cluster boxes ($4.5 billion), the summer sale for Standard mail ($24.1 million), and remaining savings from network rationalization implementation ($2.5 billion estimated.) The Postal Service has the ability, on its own, to make those $3.5 billion in savings annually, and could significantly improve the chances for Congressional passage of postal reform by making these cuts now and dropping its insistence for ending Saturday delivery as part of the reform package.

C. Other Deficit Reduction Proposals The Postal Service Can Pursue Without Collective Bargaining, Or Can Pursue Without Legislation

There are 78 deficit reduction proposals of 109 total that the Postal Service could pursue without having to engage in collective bargaining. Many of these are included in the discussion of Appendix 4 above, but 23 are not as they require or may require legislation. This list is found in Appendix 5. Twenty-five of the 78 proposals not requiring collective bargaining have annual savings attached to them. These total $3.9 billion, excluding some notable items: selling real estate assets ($85 billion), network rationalization ($4.1 billion), transferring the FERS surplus to the Postal Service or ending the annual contribution ($6.9 billion and $3 billion), ending PAEA prefunding ($5.6 billion), and an end to end GPS system ($191-$435 million ROI).

In Appendix 6 are proposals not requiring legislation but that require or may require collective bargaining. All but four of these 59 proposals are also listed in Appendix 4. The four proposals which do not require legislation but do require or may require collective bargaining are: correct OPM inflation estimate, proposal #22 (hereafter referred to only by the proposal number after the # sign); match retail hours to workload, #50; outsource custodial, vehicle service driver positions ($675 million savings annually), #72; and change pension benefits for new employees, #94.

D. Forty Deficit Reduction Proposals Requiring Collective Bargaining Or Legislation

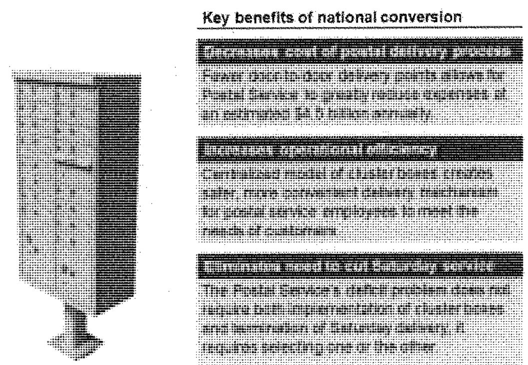
Out of 109 deficit reduction proposals identified in recent Postal Service OIG reports or GAO reports, the Postal Service can implement 54 by itself (See Appendix 4), substantially more than the 40 it can implement only with collective bargaining or with legislation or both, as detailed in the list of proposals in Appendix 7. It does not need to ask Congress to either cut Saturday delivery or find alternative savings it can enact to replace the cost of Saturday delivery, whether that is $2 billion, $1.2 billion, or even less. It does not need to engage in collective bargaining to find savings more than sufficient to cover the cost of maintaining Saturday delivery of mail.

These facts strongly support the view found in proposal #126, in an April 2010 GAO report (GAO-10-4). If the Congress acts on any deficit reduction proposal within its purview, notably greatly reducing or eliminating RHB prefunding, it should as part of that legislation require the Postal Service to act on issues within its control. Such legislation would not only resolve the issue of Saturday delivery, it would solve the Postal Service's entire structural deficit by focusing management on the list of 54 rather than the list of 40, and by focusing on the list of 54 it can actually implement, as opposed to those that require legislation or collective bargaining. Additionally, these proposals give the Postal Service the ability to preserve universal service and move it away from its obsessive focus on ending Saturday delivery

IV. Sixteen Proposals For Cutting Delivery Costs Without Cutting Saturday Mail Delivery

Beyond ending or radically overhauling PAEA's RHB prefunding requirement, the single largest deficit reduction in our list of 100 plus options is adoption of cluster boxes. OIG produced a detailed report on this proposal in 2010, as did GAO, #109 (see Appendix 3). One basic option would save $4.5 billion annually

Cluster Boxes Modernize Delivery Mechanism



as of 2011 if adopted and in place. The Postal Service could do this using the powers in its own charter, with a non-binding advisory opinion from the Postal Regulatory Commission. In addition to cluster boxes, six of the other proposals for reducing the Postal Service's deficit total between $385 million and $819 million on an annual basis, #108, #111, #112, #113, #115, and #117.

Several of the proposals have no cost estimate or expected annual revenue associated with them. Maintenance costs for the aging vehicle fleet now exceeds replacement costs, and one proposal calls for establishing a new vehicle purchase strategy instead of the current cost-inefficient "fix as fails" strategy, #114. Just ending door delivery, apart from the use of cluster boxes would save several hundred million dollars a year, #110. Six foreign posts already offer digital or hybrid options to mail delivery, the latter entailing sending mail electronically, and delivering it physically, #107. Five proposals made by OIG's Inspector General envision decoupling retail and delivery facilities throughout communities, enabling faster delivery than at the edge of cities and cross town delivery including groceries and dry cleaning, #118 – #122.

V. Twenty-Three Proposals For Cutting Health Benefit Costs

There are numerous proposals for ending or modifying the PAEA mandated annual contribution to prefunding RHB. In fact, the number of proposals alone may have prevented progress around a viable proposal and enacting legislation. Below are eight proposals from recent GAO and OIG reports (see Appendix 3):

1. Pay-as-you-go funding, instead of prefunding, savings $5.8 billion annually, #6

2. Actuarial approach to revising RHB, saving $1 billion annually or $10 billion through 2020, #7

3. Prefund RHB at 30% of its liabilities, #8

4. Revise prefunding to less than full $5.4 billion annual cost, #9

5. Revise, reduce, or eliminate RHB prefunding, #10

6. Eliminate RHB prefunding as part of the Postal Service sponsoring its own health plan, #11, #12

7. GAO modified Administration approach, $1.7 billion savings annually, #13

8. GAO modified S.1789 approach from the last Congress, $2.3 billion savings annually, #14

Three other proposals relate to the Postal Service pulling out of Federal Employees Health Benefits (FEHB) and sponsoring its own health plan. While the savings look large on paper, excluding RHB prefunding they amount to savings of $1.5 billion annually, from accounting changes, use of Medicare coverage, efficiencies in health care purchasing, and the impact on current employees, retired employees and future retired employees, #11, #12, #18. Yet another proposal suggests transferring $42 billion in FEHB from the Treasury to a Postal Service controlled fund, #3.

The Postal Service now pays 100% of life insurance premiums, whereas other federal agencies contribute 33% on average.

Two proposals would apply a comparability standard, two would tackle inflation assumptions, and two others would reduce life insurance premiums the Postal Service pays. Decreasing health benefit premiums paid by the Postal Service from the current 80% to the 72% average paid by other agencies would save $560 million based on FY2010 contribution levels, #1, #2. The Postal Service now pays 100% of life insurance premiums, whereas other federal agencies contribute 33% on average, #4, and #5. The cost of benefits since 1972 has increased 448% above Consumer Price Index (CPI) inflation. One proposal would make Cost Of Living Adjustments (COLA) benefits tied to the CPI minus total factor productivity (TFP), while the other would correct the Office of Personnel Management (OPM) inflation forecast for health care benefits, #20, #22.

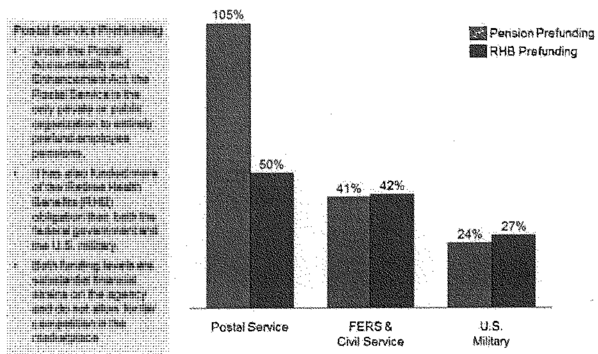
VI. Thirteen Proposals For Cutting Pension Costs

Six of the proposals would affect the Federal Employee Retirement System (FERS).[8] A 2011 GAO report suggested the Postal Service seek a $6.9 billion reimbursement of its FERS surplus, and an Administration variant of that was to amortize the reimbursement over thirty years, #95 (see Appendix 3). OIG in a 2010 report put the obligation at $6.8 billion based on an FY2009 Office of Personnel Management estimate, #98. A 2012 OIG report and 2013 GAO report suggested ending FERS pension funding, with a savings estimated at $3 billion annually based on the FY2012 FERS payment, #99, #97.

Two OIG proposals have sought cutting pension benefits based on comparisons with how much employers in the private sector pay for similar pension funds. The 2011 report notes S&P 500 companies had pension prefunding levels in 2009 at 79% of liabilities, the federal government on average for FERS and the Civil Service Retirement System (CSRS) had prefunding at 41%, and the military had prefunding at 24%. One proposal would set prefunding for postal pensions at 80% of liabilities and at 30% for RHB, and would have the effect of eliminating the PAEA mandate for annual prefunding of RHB at $5.6 billion, #102.

A 2012 OIG report notes that postal pensions are now 105% funded, $1.7 billion overfunded in CSRS, and $11.4 billion in FERS. The Postal Service has already funded 50% of its RHB obligation whereas the federal government is 42% funded and the military 27%. OIG proposes selling $85 billion in Postal Service real estate assets to fund the remaining 50% of RHB, about $46 billion, #101.

Pension And RHB Prefunding Comparison Across Federal Agencies



As a bellwether for future annual savings, an early retirement offer taken by 20,000 clerks and mail handlers in 2009 generated $350 million in net annual savings, or $17,500 per employee per year, #103. Two final proposals without savings attached are to repay the Postal Service for making military pension payments and reducing the pension benefits for new employees, #106, #94.

VII. Sixteen Proposals For Increasing Revenue Without Raising Rates

Six of these proposals from Appendix 3 involve diversification into non-postal products, #80 - #85. The ideas come from a survey of postmasters, existing legislation in Congress, and foreign posts. None of the proposals have revenue estimates associated with them. One GAO report suggests expanding government services at retail facilities for passports, selective service registration, E-Gov initiatives, partnering with commercial Internet Service Providers (ISP) to expand the National Broadband Infrastructure, and prepaid cards for electronic currency transactions, #85. The report stresses that the three biggest barriers are the Postal Service's wage level at its retail units, the current foot traffic within them, and stakeholder opposition.

Rate increases will only add to the structural deficit faced by the Postal Service by driving even more post volume away to competing products and services.

Public Internet access services, notary services, advertising space at postal facilities and on postal vehicles, check cashing, facility leasing and warehousing are the non-postal products and services noted by GAO in recent federal legislation: S. 1789, S. 1010, H.R. 2309, H.R 3591, S. 1853, H.R. 3916, H.R. 1262, and H.R. 2967, #84. Postmasters have mentioned fax services, photocopy services, notary, passports, greeting cards, ATMs, Internet or wireless community support center, gift cards, job services, public telephones and money transfers, #81.

The Postal Service generates 15% of its revenue from non-postal sources, compared to an average 40% at major foreign posts.

The Postal Service generates 15% of its revenue from non-postal sources, compared to an average 40% at major foreign posts. Doubling the current U. S. share would put it on a par with Royal Mail in the United Kingdom, #83. Existing foreign practices in one or more national posts include physical delivery of emails to individuals without Internet access, banking and insurance, savings accounts, bill payments, retirement planning, lottery tickets, home phone and broadband services, local travel tickets, online shopping, home loans, worldwide money transfer options, tax payments, payment of fines, dog licenses, charitable donations, storage billing and payment options, storage service and airline tickets.

Management improvements in Express Mail, supply management portfolios that could be doubled and project financial system segregation of duties losses total around $21.5 million annually, #91, #90 and #88. Other proposals without revenue figures attached stress more private partnerships and formal innovation processes and strategies comparable to those at other large corporations, #92 and #86.

Finally, there are legitimate questions as to whether or not ending preferential pricing for loss making products or broadening PAEA's current price cap to apply to a larger base would or could constitute rate increases. Because there are valid points that can be made on either side of these two issues, we do not include such proposals in the GCA's list in Appendix 3.

VIII. Seventeen Proposals For Cutting Costs In The Postal Service Workforce

Despite reducing labor costs and the number of employees in recent years, it remains a fact that labor costs are still about 80% of total Postal Service operating costs. Since headcount and total compensation costs did not decline faster than volume and revenue, the savings, while necessary and welcome, did not solve the underlying problem, which is the level of total compensation per career employee.

The large savings in this area can only come from cutting the career workforce, short of any breakthrough in collective bargaining on total compensation per employee. Some of this will happen as, or if, other initiatives succeed such as closing and consolidating mail processing plants to eliminate excess capacity, or closing and consolidating post offices. A GAO report from 2009 estimated that for every employee "cut" through attrition the Postal Service saves $17,500 annually, #23 (see Appendix 3). OIG estimated in 2012 that 189,000 employees met the age and service requirements for retiring with an immediate annuity, #37. Success with separation incentives to postmasters and mail handlers in FY2012 saved the Postal Service $542 million according to a 2012 GAO report, #26. These are initiatives the Postal Service could undertake without legislation. If we include ideas that would need Congressional action, revising workers compensation laws for employees eligible for retirement could save up to $1.4 billion annually, as noted by GAO in a 2010 report, #27.

There are smaller savings options which, when added together, become significant. There is $143 million of annual savings from reducing costs associated with Postal Service Inspection Service activities, postage stamp management and aligning benefits in these areas with those of other federal agencies, #33. Christmas supplemental hours are no longer necessary, and ending overtime pay in this area could have saved close to $3 million over the two years 2011 and 2012, #35. The Postal Service has not capped officer salaries, and as a result, overpaid them by $110,011 in calendar year 2011.

Some of the largest possible savings available in the workforce area entail proposals without any estimate provided for the annual amount saved. Instead of proposing to cut critical services to customers such as ending Saturday delivery, the savings from these proposals should be estimated by the agency that made them or by the Postal Service itself. These include:

1. Create a two-tiered wage system, one for new hires and the other for current employees, #28

2. Eliminate layoff protections in collective bargaining agreements, enabling cuts of 125,000, #32

3. Reduce absenteeism rate to civilian sector levels by offering fewer leave benefits and fewer incentives to accumulate leave, and mandate supervisors to comply with attendance control procedures for unscheduled leave, #34

4. Change the retirement formula that uses the three highest years' salary to one that uses the highest five, #38

5. Facilitate downsizing the labor force through re-training, relocation and job search services, #31

6. Require binding arbitration to take account of Postal Service financial conditions (Existing proposal), #29

7. Outsource work wherever cost effective, #30

A number of these alone or in combination would produce greater savings than ending Saturday delivery.

IX. Sixteen Proposals For Cutting Costs Or Raising Revenue At Retail

The Postal Service is constantly on the defensive when it comes to diversifying into non-postal products and services at its retail outlets. (These alternatives are discussed in Section VII.) Many observers argue that the offerings that enable foreign national posts to be financially sound despite Internet diversion are "off-limits" to the Postal Service because of lobbying pressure from the affected industries such as banking, cell phone service, or insurance. This argument puts the cart before the horse. The fact is the compensation structure of post offices is way too high at present to make a remunerative entry into almost any retail product or service it could sell. By default, the Postal Service is left with options that involve other government agencies - federal, state or, local - which are saddled with the same high compensation structure.

These government options for the Postal Service retail outlets in Appendix 3 include:

1. Using post offices to help people interface with other federal departments and agencies, #58

2. Providing emergency government services, #59

3. Using post offices for community bulletin boards, license applications, permits and polling/opinion gathering, #60

4. Using post offices as centers of continuous democracy, #61

According to GAO, in FY2010 $5 billion out of $18 billion in total revenue at retail came from sources outside post offices, #42. Unfortunately, offering stamps at grocery stores and automated services at kiosks as well as online creates a greater problem of excess capacity at brick and mortar post offices unless the movement of services out of brick and mortar facilities is accompanied by a reduction in the number and size of post offices.

The 2011 goal set by the Postal Service was to reduce only 1% of the 284 million square feet at the owned or leased 33,000 retail facilities. That is 2.84 million square feet, while the estimated amount of excess capacity is 68.2 million interior square feet, 24% of the total. The excess capacity includes 12,356 unmanned windows and 20 million excess terminal work hours of 20 million, #49. OIG estimates the savings from eliminating excess capacity would be $3.48 billion over 10 years, a simple average of $348 million in savings annually, #51. In a small sample of 117 leases, OIG found in its 2009 report that 35 were being charged $476,000 above market price, #52.

In 2011, the OIG recommended closing 12,000 of the 37,000 retail post offices, #44, #45. Yet, the Postal Service as of January 2013 had not even made decisions about 600 stations, branches, and retail annexes it was supposed to under the Retail Access Optimization Initiative (RAOI) dated July 2011, #53. Selling Postal Service real estate assets valued at $85 billion could eliminate financial deficits associated with prefunding RHB and other benefits.

X. Fourteen Proposals For Cutting Mail Processing Costs Beyond Closing Plants

The most publicized efforts to cut costs in mail processing concern the Postal Service's network optimization initiative. No fewer than five of the 14 proposals in this area concern downsizing the number of Processing and Distribution Centers (P & DC). See #67 – #71 in Appendix 3. The emphases have been that processing capacity for First Class Mail exceeds needs by 50%, #67, and that 300 mail processing plants should be closed, #68. OIG commented in 2011, that cutting 135 P & DCs would save $2.6 billion, #70.

GAO has also reported on the Postal Service's latest five-year plan in this regard: close 223 processing plants, cut 35,000 positions, and eliminate 3,000 machines in the process, largely ending overnight delivery for First Class and periodicals, #69. A 2013 OIG report states that 48 plants were consolidated in July/August 2012. Plans to close 100 plants in 2013 have been reduced to 92 and final cuts of 114 plants in 2014 have been cut to 112, #64. Under $2 billion of the Postal Service's projected $4.1 billion in savings from closing and consolidating plants has been accomplished as of May 2013. Nonetheless, this area has been one of the Postal Service's most successful endeavors in trimming its deficit.

Other opportunities for savings in mail processing focus directly on labor costs, rather than indirectly from cutting plant and equipment costs. Two of these alone would produce $1.64 billion in annual savings in lieu of ending Saturday delivery. Outsourcing cleaning/janitorial services and postal vehicle service driver positions would save $675 million annually according to a 2012 report by OIG, #72. Managing labor more efficiently within plants, separate from downsizing plants, could save $969.5 million annually according to a 2009 OIG report, #74. Some of the areas include less usage of overtime at plants, better mail handling, improved manual operations and allied operations performance, and better use of automation and mechanized equipment together. These areas would save 23 million work hours measured on an FY2008 basis.

XI. Other Proposals For Cutting The Postal Service's Structural Deficit

The Postal Service could save $33.6 million annually by consolidating its field structure and closing offices, currently open, that are within 50 miles of one another, #124, #125 (see Appendix 3). It could save $13 million annually in data costs by simply reducing manual data collection for Revenue, Pieces, and Weight (RPW) reports in favor of modifying existing automated processes, #128. By reforming or eliminating its Thrift Savings Plan contributions the Postal Service could save up to $1 billion annually based on the current plan's cost in FY2012, #127. Increasing the Postal Service's independence from national budget considerations could save $100 million annually, #129. The changes required would include conforming the House's pay-as-you-go (PAYGO) rule to the Senate's, shifting off budget the Postal Service's share of the Civil Service Disability and Retirement Fund (CSRDF) and the Postal Service Retiree Health Benefits Fund (PSRHBF), and shifting the cost of free mail for the blind and overseas voters to the appropriate federal agencies.

One proposal without cost savings estimated is reviewing the need for 74 district offices and nine area offices, #123 in Appendix 3. A final proposal states that if Congress acts on deficit reduction measures requiring its approval, the Postal Service should possibly in turn be compelled to act on issues within its control, #126.

XII. Conclusion

All of the proposals discussed throughout this report provide the ability to implement a commonsense solution to fixing the Postal Service and setting it down a viable path while preserving universal services and without raising rates. GCA hopes that decision-makers can take advantage of these opportunities to real postal reform while upholding these principles.

About This Commonsense Solution

The Greeting Card Association wishes to thank Dr. James Clifton and Dr.Reza Saidi of Clifton Associates LLC for their economic analysis, and David Stover for his legal guidance while developing this solution to the Postal Service's budget deficit.

The Greeting Card Association is the U.S. trade association serving the greeting card and social expression industry. Founded in 1941, the GCA today represents nearly 200 American and international publishers from diverse businesses – ranging from young start-ups to established companies of all sizes, scopes and years in the industry – as well as suppliers that provide production services and product distribution at the wholesale level.
The GCA is committed to: Celebrating, promoting, and preserving the tradition of sending greeting cards.

- Providing meaningful opportunities for information exchange and business development.
- Keeping members informed of trends and issues that might impact the industry.
- Representing the industry before government/regulatory agencies.
- Serving as the industry voice to the consumer and trade media.

For more on the GCA's Commonsense Solution:
www.CommonsensePostalSolutions.org
For more on the GCA: **www.greetingcard.org**

APPENDIX 1: Statistical Tests Of Postal Service Deficit Forecast Through 2016

USPS Deficit/Surplus

	Year	Squared Year	Deficit
1	2003	4012009	$3.9
2	2004	4016016	$3.1
3	2005	4020025	$1.4
4	2006	4024036	$0.9
5	2007	4028049	$3.3
6	2008	4032064	$2.8
7	2009	4036081	-$2.4
8	2010	4040100	-$3.0
9	2011	4044121	-$5.1
10	2012	4048144	-$5.4

QUADRATIC Model

Regression Statistics	
R Square	**84.9%**

ANOVA

	DF	*SS*	*MS*	*F*	*gnificance F*
Regression	2	98.6408	49.32042	19.63374	0.001347
Residual	7	17.5842	2.512024		
Total	9	116.225			

	Coefficients	*Standard Error*	*t Stat*	*P-value*
Intercept	-475694.0667	277974.8331	-1.71128	0.130765
Year	474.9693182	276.9367239	1.715082	0.130044
squared	-0.118560606	0.068975509	-1.71888	0.129328

LINEAR Model

Regression Statistics	
R Square	**78.5%**

ANOVA

	DF	*SS*	*MS*	*F*	*gnificance F*
Regression	1	91.2189	91.2189	29.18299	0.000644
Residual	8	25.0061	3.1258		
Total	9	116.225			

	Coefficients	*Standard Error*	*t Stat*	*P-value*
Intercept	2110.866667	390.7569134	5.401994	0.000644
Year	-1.051515152	0.194648325	-5.40213	0.000644

H0: Th linear model and the quadratic model are the same
Ha: The linear model and the quadratic model differ

F-Test $\dfrac{[(\text{SSErestricted} - \text{SSEcomplete})/(\text{DFrestricted}-\text{Dfcomplete})]}{(\text{SSEcomplete}/\text{DFcomplete})}$ 2.955

where :

SSErestricted is the sum of squared error or residual for the restricted model which is linear model = 25.0061
SSEcomplete is the sum of squared error or residual for the complete model which is the quadratic model = 17.5842
DFrestricted is the degrees of freedom of residual for the restricted model which is the linear model = 8
DFcomplete is the degrees of freedom of residual for the complete model which is the quadratic model = 7

F-Table F,1,7,5% Obtained from the F-table for 5% significance level and the degrees of freedom of 1 and 7. 5.591

Conclusion Since F-Test value is less than F-Critical value, we are 95% confident that there is no difference between the two models.

Furthermore: Despite that R-squared of the linear model is 78.5% which is smaller than the R-squred for quadratic model which is 84.9%, the F-value of the linear model is 29.18 which is much larger than F-value of the quadratic model which is 19.63. In other words, overal, the linear model is more significant (P-value=0.000644) compared to the quadratic model (P-value=0.001347)

Note: It is important to note that the sample size is too small to make true inference, unless, we assume that deficit is normally distributed.

APPENDIX 2: EFFECTS OF 109 DISTINCT PROPOSALS ON SERVICE AND RATES

NOTE: Some categorizations in right-hand column are left blank because the item is substantially identical with another item; cross-references are given. In some cases affecting employee compensation, benefits, tenure, etc., where legislation would be required, it is assumed that such legislation would eliminate any bargainable issues, and bargaining is not listed in the right-hand column. The chart below contains 129 numbered proposals, but after factoring out similar alternatives there remains 109 distinct options.

List No.	Description	Categorizations
1	Cut health benefit contribution to 72% government level	Bargaining or legislation required No service effect No rate effect
2	[same as 1]	
3	Transfer $42B health care assets from Treasury to the Postal Service Fund	Legislation required No service effect No rate effect
4	Reduce life insurance contribution to 33% government level	Bargaining required No service effect No rate effect
5	Reduce Postal Service health, life contribution rate for actives	Bargaining required No service effect No rate effect
6	Pay-as-you-go health benefit funding	Legislation required No service effect No rate effect
7	Implement actuarial approach to retiree health benefit funding	Legislation required No service effect No rate effect
8	Prefund retiree health benefits at 30% of liability	Legislation required No service effect No rate effect
9	Reduce RHB prefunding annual requirement to <$5.4B	Legislation required No service effect No rate effect
10	Reduce or eliminate RHB prefunding annual requirement	Legislation required No service effect No rate effect
11	Postal Service to sponsor own health plan	Legislation required No service effect No rate effect
12	Postal Service to leave FEHB + Close 48% of processing plants	Legislation required (FEHB) No service effect necessary No rate effect
13	Administration proposal on RHB prefunding	Legislation required No service effect No rate effect
14	S. 1789 approach on RHB prefunding	Legislation required No service effect No rate effect
15	[same as 6]	
16	H.R. 2309 modified approach on RHB prefunding	INCREASES DEFICIT

17	End RHB prefunding; use existing funds	Legislation required No service effect No rate effect
18	[same as 11]	
19	Use pension, health overfunding	Legislation required No service effect No rate effect
20	Tie benefits to inflation (COLA)	Legislation probably re-quired Bargaining required No service effect No rate effect
21	Repay shift in military pensions	Legislation probably re-quired No service effect No rate effect
22	Correct OPM inflation estimate	Legislation not required OPM concurrence required No service effect No rate effect
23	Eliminate employees through attrition	Legislation not required Bargaining not necessarily required No service effect No rate effect
24	Reduce workforce through retirements	Legislation not required Bargaining not required No service effect No rate effect
25	Offer early retirement incentives	Legislation not required Bargaining not required No service effect No rate effect
26	Offer separation incentives – postmasters, mail handlers	Legislation not required Bargaining not required No service effect No rate effect
27	Reform workers' compensation for retire-ment eligible	Legislation required No service effect No rate effect
28	Implement two-tiered wage system (new hires vs. current employees)	Bargaining required No service effect No rate effect
29	Require arbitrators to recognize Postal Service financial condition	Legislation required No service effect No rate effect

30	Outsource work where cost-effective	Bargaining required No service effect No rate effect
31	Labor out-transition services (training, job search, relocation)	Legislation not required Bargaining not required No service effect No rate effect
32	Eliminate layoff protection to permit work-force reduction	Bargaining required No service effect No rate effect
33	Reduce security, stamp management costs; align benefits with other agencies	Bargaining required No service effect No rate effect
34	Reduce incentives to use leave, enforce leave management	Bargaining required for some No service effect No rate effect
35	Eliminate Christmas supplemental hours, related overtime	Bargaining may be required No service effect No rate effect
36	Observe officer salary cap	Bargaining not required No service effect No rate effect
37	[same as 24 – 26]	
38	Change retirement formula to use high 5 years as basis	Legislation required No service effect No rate effect
39	[same as 25] + transfer FERS overpayment to THE POSTAL SERVICE for use in buyouts	Legislation required Bargaining not required No service effect No rate effect
40	Move more retail to stores, self-service	Legislation not required Bargaining not required No service effect necessary No rate effect
41	Offer parcel pickup at stores or 24-hr. lockers	Legislation not required Bargaining not required No service effect necessary No rate effect
42	Add retail locations other than post offices	Legislation not required Bargaining not required No service effect No rate effect
43	Locate retail where/when customers are present	Legislation not required Bargaining not required No service effect

		No rate effect
44	Reduce retail network	Legislation not required Bargaining not required No service effect necessary No rate effect
45	Close 12,000 retail facilities	Legislation not required Bargaining not required No service effect necessary No rate effect
46	Conduct communication/outreach to inform public of increased access	Legislation not required Bargaining not required No service effect necessary No rate effect
47	Substitute alternatives for post offices; redesign usps.com site	Legislation not required Bargaining not required No service effect necessary No rate effect
48	Offer stamps through mail, Internet, stores	Legislation not required Bargaining not required No service effect necessary No rate effect
49	Sell unused space or release it to other U.S. agencies	Legislation not required Bargaining not required No service effect No rate effect
50	Match retail hours to workload	Legislation not required Bargaining probably required No service effect No rate effect
51	Dispose of excess space, save utility, custodial costs	Legislation not required Bargaining not required No service effect No rate effect
52	Reform leases which pay above market rent	Legislation not required Bargaining not required No service effect No rate effect
53	Pursue Retail Access Optimization Initiative [now Post Plan]	Legislation not required Bargaining not required No service effect No rate effect
54	Sell Postal Service real estate assets	Legislation not required Bargaining not required No service effect No rate effect

55	Expand on-line platform to include hard-copy cards, invitations	Legislation probably not required Bargaining not required No service effect No rate effect
56	Offer digital access through Postal Service website	Legislation not required Bargaining not required No service effect No rate effect
57	Enable e-mail box interfaced with physical mailbox	Legislation required No service effect No rate effect
58	Use post offices to complement Postal Service digital platform, with human staff to help interface with other U.S. agencies	Legislation possibly required Bargaining possibly required No service effect No rate effect
59	Provide emergency government services, interactions	Legislation possibly required Bargaining not required No service effect No rate effect
60	Offer community bulletin boards, licenses, permit applications, citizen polling/opinion gathering	Legislation possibly required Bargaining not required No service effect No rate effect
61	Centers of continuous democracy	Legislation possibly required Bargaining not required No service effect No rate effect
62	Digital services less space and labor intensive than current services	Legislation possibly required Bargaining probably required No service effect necessary No rate effect
63	Accelerate closing of processing facilities to keep pace with volume decline	Legislation not required Bargaining not required No service effect necessary No rate effect
64	[Similar to 63]	
65	Relax delivery standards to facilitate plant closings	Legislation not required Bargaining not required Service effect No rate effect
66	Set up BRAC-type mechanism to facilitate plant closings	Legislation required Bargaining not required No service effect necessary No rate effect

67	Remove excess processing capacity	Legislation not required Bargaining not required No service effect necessary No rate effect
68	Close 300 processing plants	Legislation not required Bargaining not required No service effect necessary No rate effect
69	Relax FCM, Periodicals delivery standards to eliminate plants, machines, trips	Legislation not required Bargaining not required Service effect No rate effect
70	Eliminate 135 P&DCs	Legislation not required Bargaining not required No service effect necessary No rate effect
71	"Right-size" mail processing facilities	Legislation not required Bargaining not required No service effect necessary No rate effect
72	Outsource custodial, vehicle service driver positions	Legislation probably not required Bargaining required No service effect No rate effect
73	Eliminate 10 CSBCS machines (obsolete recommendation)	Legislation not required Bargaining not required No service effect No rate effect
74	Use less overtime in processing; improve mail handling, manual, and allied operations performance	Legislation not required Bargaining possibly required No service effect No rate effect
75	Improve UAA metrics and streamline UAA workflow	Legislation not required Bargaining not required No service effect No rate effect
76	Simplify mail acceptance rules	Legislation not required Bargaining not required No service effect No rate effect
77	Consider 55 various GAO revenue initiatives	Legislation not required Bargaining not required No service effect Rate effect
78	Postal Service/McKinsey identify 100	[Indeterminate]

	cost/volume/revenue initiatives	
79	Provide volume incentives for bulk mail	Legislation not required Bargaining not required No service effect Rate effect
80	Increase revenue through new or enhanced products	Legislation not required Bargaining not required Service effect possible Rate effect
81	Offer nonpostal services (photocopy, fax, passport, Internet, ATMs, etc.)	Legislation required Bargaining not required No service effect No rate effect
82	Offer nonpostal services including e-mail delivery, financial services, tax payment acceptance, etc. (from review of foreign posts)	Legislation required Bargaining not required No service effect No rate effect
83	Increase proportion of revenue from nonpostal services	Legislation required Bargaining not required No service effect No rate effect
84	[Similar to 77]	Legislation required Bargaining not required No service effect No rate effect
85	Expand electronic nonpostal services; possibly adjust the Postal Service wage structure to make feasible	Legislation required Bargaining possibly required No service effect No rate effect
86	Copy corporate formal innovation processes; internal or partnership implementation	Legislation possibly required Bargaining not required No service effect necessary No rate effect
87	Pricing structure complex; methods of insuring cost recovery lag technological potential; exploit flexibilities in statute, formulate strategic plan for doing so	Legislation possibly required Bargaining not required No service effect necessary Rate effect
88	Expand successful Supply Management Portfolio revenue generators	Legislation not required Bargaining not required No service effect No rate effect
89	Ensure evaluation of NSAs does not credit money-losing contracts with positive revenue	Legislation not required Bargaining not required No service effect No rate effect
90	Segregate duties so that same officer does	Legislation not required

	not create/approve project; correct terminal dues billing	Bargaining not required No service effect No rate effect
91	Improve Express Mail corporate account management	Legislation not required Bargaining not required No service effect No rate effect
92	Increase Postal Service/private sector partnerships	Legislation possibly required Bargaining possibly required No service effect No rate effect
93	Direct appropriations from Congress	Legislation required Bargaining not required No service effect No rate effect
94	Change pension benefits for new employees	Legislation not required Bargaining required No service effect No rate effect
95	FERS surplus transfer to the Postal Service	Legislation required Bargaining not required No service effect No rate effect
96	Amortize FERS surplus over 30 years (Administration proposal)	Legislation required Bargaining not required No service effect No rate effect
97	End FERS pension funding	Legislation required Bargaining not required No service effect No rate effect
98	[Same as 99]	
99	Refund FERS overpayment	Legislation required Bargaining not required No service effect No rate effect
100	Limit FERS annuity supplement to those subject to mandatory retirement	Legislation required Bargaining not required No service effect No rate effect
101	Postal Service pension benefits overfunded; use real estate assets to fund the 50 percent of retiree health benefits still unfunded	Legislation required Bargaining not required No service effect No rate effect
102	Set Postal Service pension funding at 80 percent, retiree health benefits at 30 per-	Legislation required Bargaining not required

	cent; eliminates PAEA annual prefunding payment	No service effect No rate effect
103	Continue early retirement offers to clerks, mail handlers	Legislation not required Bargaining not required No service effect No rate effect
104	Increase employee contributions to CSRS and FERS	Legislation required No service effect No rate effect
105	Return CSRS overpayment to Postal Service	Legislation required No service effect No rate effect
106	[Same as 21]	
107	Offer digital or hybrid alternatives to hard-copy mail delivery (cf. foreign posts)	Legislation required Bargaining possibly required Service effect Possible rate effect
108	[Similar to 111]	
109	Expand cluster box delivery	Legislation not required Bargaining not required Service effect (final delivery) No rate effect
110	End door delivery	Legislation not required Bargaining not required Service effect (final delivery) No rate effect
111	Eliminate some city routes in favor of rural routes	Legislation not required Bargaining possibly required Service effect (final delivery) No rate effect
112	Control over-budget overtime in city delivery	Legislation not required Bargaining not required No service effect No rate effect
113	Reform USO to support Postal Service provision of broadband in high-cost areas	Legislation required Bargaining not required No service effect necessary No rate effect
114	Establish new vehicle purchase strategy to replace "fix as fails"	Legislation not required Bargaining not required No service effect No rate effect
115	Adopt end-to-end GPS system to reduce	Legislation not required

	idle time, increase efficiency in delivery and transportation	Bargaining not required No service effect No rate effect
116	The Postal Service should have considered PRC 5-day delivery savings estimate in five-year strategic plan, which reduces projected savings from $3B to $ 1.7B.	Legislation not required Bargaining not required Service effect No rate effect
117	Adopt electric vehicles	Legislation not required Bargaining not required No service effect No rate effect
118	Decouple retail and delivery operations	Legislation not required Bargaining possibly required No service effect No rate effect
119	Offer "Co-opetition" in delivery; all carriers share the Postal Service vehicle	Legislation not required Bargaining possibly required No service effect No rate effect
120	Universal delivery using evaluated routes, other modes of delivery (property line, cluster boxes)	Bargaining or legislation required Service effect (final delivery) No rate effect
121	Delivery facilities throughout communities rather than on edge of cities for faster delivery	Legislation not required Bargaining not required Service effect No rate effect
122	Rapid cross-town delivery. To include groceries, dry cleaning, as well as mail	Legislation required Bargaining probably required Service effect Rate effect possible
123	Review need for 74 District, 9 Area offices	Legislation not required Bargaining not required No service effect No rate effect
124	Reduce field administrative offices	Legislation not required Bargaining not required No service effect No rate effect
125	Similar to 128-129; close District offices within 50 miles of each other	Legislation not required Bargaining not required No service effect No rate effect

126	Congressional requirement that the Postal Service act on issues within its control, as part of any legislation	Legislation required Bargaining possibly required Service effect possible Rate effect possible
127	Reform Thrift Savings Plan contribution	Legislation required Bargaining possibly required No service effect No rate effect
128	Reduce manual data collection for RPW in favor of modifying existing automated procedures	Legislation not required Bargaining not required No service effect No rate effect
129	Increase the Postal Service independence of Federal budget (various items)	Legislation required Bargaining not required No service effect No rate effect

APPENDIX 3: CONSOLIDATED ALTERNATIVES TO ENDING SATURDAY MAIL DELIVERY GAO/OIG DEFICIT REDUCTION PROPOSALS, 2009-2013

I. Health Benefits and Costs: 22 Proposals

1. Cut employee health benefit premiums paid by Postal Service to 72% other Federal agencies pay from 80% the Postal Service pays, GAO 8/9/09 958-T
2. Decrease health benefit premium cost share of Postal Service from 80 to 72% to save $560M in FY2010, GAO 9/6/11, 92
3. Request $42B in health benefit assets FEHB be transferred from Treasury to Postal Service Fund, GAO 9/6/11, 926T
4. The Postal Service pays 100% of life insurance premiums, other fed agencies about 33%, GAO 8/9/09 958-T
5. Reduce Postal Service health and life insurance contribution rates for active employees, 4/10, GAO-10-455
6. Pay as you go prefunding would save over $44B through 2020, GAO 9/6/11, 926T, $5.8B annually
7. Actuarial approach to revise retiree health payment benefits would save $10B through 2020, GAO 9/6/11, 926T
8. Prefund retiree health care benefits at 30% of its liability, GAO 9/6/11, 926T
9. Ask Congress to revise prefunding requirement to less than $5.4B full annual amount, GAO 8/9/09 958-T
10. Revise retiree health benefit pre-funding, reduce or if needed eliminate it, 4/10, GAO-10-455
11. Postal Service to sponsor own health benefit plan, $1.5B excluding RHB, GAO, 9/6/11, 926T
12. Postal Service proposed pulling out of FEHB, savings $60—$70B. Also proposed closing and consolidating 48% of its mail processing plants, including 220,000 career positions over next three years. OIG HR-MA-12-001

13. Funding options for retiree health benefits (prefunding): Current law (PAEA), modified, $57.7B; $7.2 annual aver. Administration's approach, modified -- $44.1; average annual $5.5B, $1.7B annually savings compared to PAEA base-line, 12/12, GAO-13-112,

14. S. 1789, modified, $39B; $4.9 aver annual, $2.3 billion annually, 12/12, GAO-13-112,

15. Pay-as-you-go, $5.5—$5.8Bannually, 12/12, GAO-13-112,

16. H.R. 2309, modified, $61.1B; $7.6B average annually, adds to deficit, 12/12, GAO-13-112

17. Stop prefunding, use existing funds to pay current and future premiums, 12/12, GAO-13-112

18. Postal Service to offer own health care benefits plan. Decreases costs by over $63 billion. Requires accounting changes, use of Medicare coverage, efficiencies in health care purchasing, impact on current, retired and future retired. OIG FI-MA-12-014

19. Overfunding issues for pension and retiree healthcare funds. OIG proposals herein could potentially recover $142.4B. No RHB prefunding. Benchmark levels for prefunding current retirees pension and health benefits. Pay existing retirees health insurance premiums from retiree health fund. Extinguish debt to Treasury. OIG FT-MA-10-002

20. Cost of benefits since 1972 448% above inflation; make COLA benefits tied to CPI-TFP, OIG-RARC-WP-11-007

21. Repay shift in military pensions to Postal Service, OIG IG

22. Correct OPM inflation forecast for health care, OIG IG

II. <u>Postal Service Workforce</u>: 17 Proposals

23. Cut employees through attrition, 162,000 eligible in 2009, 300,000 within 4 years, GAO 8/9/09 958-T, $5.25B @ $17,500 savings per employee

24. Also, reduce workforce through retirements 4/10, GAO-10-455

25. Offer early retirement incentives, GAO 8/9/09 958-T

26. Separation incentives to postmasters and mail handlers, GAO-13-347T, $542M actual savings in FY2012

27. Have Congress revise workers comp laws for employees eligible for retirement, $1.4 billion is current annual cost, 4/10, GAO-10-455

28. Two tiered wage system, one for new hires, another for existing, 4/10, GAO-10-455

29. Require any binding arbitration to take account of the Postal Service's financial condition, 4/10,GAO-10-455

30. Outsource work where cost effective, 4/10, GAO-10-455

31. Labor transition plans like training, relocation and job search services, GAO 2/11, 282

32. Eliminate layoff protections in collective bargaining so it can cut 125,000 career employees by 2015, GAO 9/6/11, 926T

33. Reduce costs associated with the Postal Service Inspection Service activities and armed security forces, postage stamp management and employee benefits. Align benefits with other federal agencies. $143M annual savings. OIG FF-AR-11-009

34. Total absenteeism rate for the Postal Service comparable to overall federal sector but higher than civilian sector. The Postal Service offers more leave benefits than civilian sector and offer fewer incentives to accumulate leave. Supervisors not complying with attendance control procedures when it comes to unscheduled leave. OIG HM-AR-10-001

35. Christmas supplemental hours no longer necessary. Ending overtime pay for this would save more than $2,9M over two years 2011 and 2012. OIG DR-AR-10-003

36. Postal Service has a cap on officer salaries that is ignored. In CY 2011, the Postal Service paid officers $110,011 above the cap. OIG FT-AR-13-001

37. In 2012, 189,000 employees will meet the age and service requirements for retiring with an immediate annuity. Voluntary early retirement; cash buyouts; additional years of service credit; re-employment for annuitants. OIG HR-MA-12-001

38. Change retirement formula that uses highest 3 years salary to one that uses highest 5 years. OIG HR-MA-12-001

39. S. 1789 allows Postal Service to offer one year of additional credited service in CSRS and up to two years for those in FERS as an incentive to retire. Direct FERS overpayment to be transferred to the Postal Service and used for buyouts up to $25,000 per employee. OIG HR-MA-12-001

III. Retail Related: 23 Proposals

40. Move more retail services to private stores and self-service, 4/10, GAO-10-455

41. Parcel pick-up and grocery stores (longer hours) or at 24 hour parcel lockers publicly located. Partners stay open longer, GAO 2/11, 282

42. More locations than post offices, and for longer hours, 11/11, GAO-12-100 ($5B of its $18B in fy2010 retail revenue came from alternatives, 11/11, GAO-12-100)

43. Put retail outlets where customers are at hours they are there

44. Reduce network of 37,000 retail facilities, GAO 8/9/09 958-T

45. Close 12,000 retail facilities, GAO 9/6/11, 926T

46. Communication and outreach strategies to inform public officials and customers of increased access to products and services, GAO 2/11, 282

47. Alternatives to Post Offices: Redesign USPS.com, 11/11, GAO-12-100

48. Buy stamps through mail, on Internet, and at grocery stores, 7/09, GAO-09-937SP

49. Excess interior space at post offices is 67 million square feet, 24% of total space, including 12,356 unmanned windows. The Postal Service should provide transactional space to other federal entities, lowering overall federal lease costs. H.R. 1734 proposes selling surplus properties government wide, consolidating and collocating space. In 2011 excess terminal work hours were 20 million. OIG DA-MA-12-003

50. Balance service with cost savings opportunities by matching retail hours to workload. Reports on success at the Antler and Goldsboro POs. OIG CI-MA-12-002

51. The Postal Service owns or leases 33,000 facilities with 284 million interior square feet. 2011 target is to reduce only 1% of that. 24% of existing square footage is excess compared to 13.4% of current commercial vacancy rate. Can realize $3.48B savings over 10 years by disposing of excess lease, custodial and utility costs. OIG DA-AR-11-009

52. 117 leases reviewed found 35 were paying $476,000 above market rates. OIG SA-MA-09-002

53. As of January 2013, the Postal Service had not followed through on its Retail Access Optimization Initiative (RAOI, July 2011) to make decisions which of 600 stations, branches and retail annexes it would close. OIG DR-MA-13-001

54. Sell Postal real estate assets, $85B, OIG IG Speech

55. Expand online platforms to include hard copy cards and invitations people prefer

56. Digital access through the Postal Service website, OIG IG Speech

57. E-mail box interfaced with physical mailbox, OIG, IG Speech

58. Use post offices to complement Postal digital platform, with humans to help interface with other federal departments and agencies, OIG IG Speech

59. Emergency government services and interactions, OIG IG Speech

60. Community bulletin boards, license applications, permits, citizen polling/opinion gathering, OIG IG Speech

61. Centers of Continuous Democracy, OIG IG Speech

62. Digital Services less labor and space intensive than current postal services, OIG IG Speech

IV. Mail Processing Capacity: 14 Proposals

63. As of 2010, (FY2005-FY2009 inclusive) the Postal Service was not closing facilities and reducing employment fast enough to offset volume and revenue declines. 39 AMP initiatives were canceled. 68 AMCs were closed, and 12 RECs. Only 2 P&DCs were closed along with 5 annexes. Total facilities were at 599 at end of FY2009, down from 677 in FY2005. OIG EN-AR-10-001

64. 48 plants consolidated July-August 2012; 100 in 2013, reduced to 92; 114 in 2014, reduced to 112, (PRC $2.6B savings 12/2011; $1.6B 4/2012 OIG NO-MA-13-004

65. Relax delivery standards to facilitate plant closures and consolidations--4/10, GAO-10-455

66. Set up a mechanism similar to BRAC for cutting excess plant capacity, 4/10, GAO-10-455 (OBSOLETE)

67. Remove excess capacity in mail processing, processing for first class mail exceeds needs by 50%, GAO 8/9/09 958-T

68. Close 300 mail processing plants, GAO 9/6/11, 926T

69. Close 223 processing plants, cut 35,000 positions, eliminate 3,000 machines, eliminate 376 million trips, from relaxation of First Class and Periodical delivery standards, $4.1 billion annual savings, GAO-12-470,

70. Cut 135 P & DC's, $2.6B, OIG – RARC-WP-11-006

71. Right-size mail processing facilities, OIG IG Speech

72. Some postal wage rates exceed those in the Service Contract Act (SCA). Outsource cleaning/janitorial services, and postal vehicle service driver positions. Saves $675M annually. OIG CA-AR-12-001

73. Eliminate ten CSBCS machines. Saves $3M over ten years. OIG DR-AR-10-004 (OBSOLETE)

74. Less usage of overtime at plants, better mail handling, manual operations performance, allied operations performance, as well as use of automated and mechanized equipment could save 23 million work hours in FY2008, avoiding $969.5M in costs annually. OIG NO-MA-09-002

75. Improve UAA reporting metrics and streamline UAA mail workflow. Now spending over $1B annually. OIG IS-AR-09-007

76. Simplify mail acceptance rules, OIG IG Speech

V. <u>Revenue Options</u>: 17 Proposals

77. 55 Revenue Initiatives, GAO – 13 – 216

78. The Postal Service management and McKinsey and Co. have identified over 100 innovative ideas to lower costs, increase mail volumes or retain volumes. OIG CI-AR-12-001

79. Provide volume incentives for bulk mail, 4/10, GAO-10-455

80. Increase revenue through new or enhanced products, GAO 8/9/09 958-T

81. From postmasters: fax services, photocopy services, notary, passports, greeting cards, ATMs, Internet or wireless fidelity' community support center, gift cards, job services, public telephones, money transfers. OIG DA-MA-12-005

82. From looking at foreign posts: physical delivery of emails to individuals without internet access, banking and insurance, savings accounts, bill payments, retirement planning, lottery tickets, home phone service and broadband, local travel tickets, online shopping, loans, worldwide money transfer options, traffic and parking fine payments, home loans, accepts income and property tax payments,

dog license renewals, donations to charities, storage billing and payment options, storage services, airline ticket purchases. OIG DA-MA-12-005

83. Greater diversification: 15% of the Postal Service revenues from non-postal; 40% of foreign posts, (Goal: Doubling US share from 13% to 26% would put it on a par with Royal Mail), OIG RARC-WP-12-002

84. Non-Postal products and services suggested in recent legislation include public Internet access services, notary services, advertising at postal facilities and on vehicles, check cashing, facility leasing and warehousing services. S. 1789; S. 1010; H.R. 2309; H.R. 3591; S. 1853; H.R. 3916; H.R.1262; H.R. 2967. OIG DA-MA-12-005

85. Expand government services at retail facilities to facilitate E-Gov initiatives, passports, selective service registration; expand National Broadband Infrastructure initiative through partnerships with commercial ISPs; provide electronic currency transactions through prepaid cards. Biggest barrier to all these is current wage level at the Postal Service retail units, foot traffic, and stakeholder opposition. OIG DA-MA-12-005

86. Large corporations generate a significant part of their total revenue from formal innovation processes and strategies for themselves or by partnering with stakeholders to grow revenue streams. The Postal Service should do the same. OIG CI-AR-12-001

87. Current pricing structure is complex. Methods for ensuring prices cover costs have not kept pace with the available technology. The Postal Service has not fully explored flexibilities in the law nor formulated a strategic plan that does. OIG CI-AR-12-002

88. Revenue generating efforts in Supply Management Portfolios that are successful (and can be expanded) are: royalty payments for technologies developed by its contractors; ads posted on transportation trailers; license fees for cluster box unit (CBU) of $627,000 annually; recycling revenue of $12.4M in FY2008; investment recovery revenue of $2.2M in FY2008. OIG CA-AR-10-001

89. The Postal Service reported its FY2009 summer sale (Standard Mail Volume Incentive) netted $24.1M. OIG questions a number of procedures the Postal Service used in the calculation, and concludes the Postal Service may actually have lost money on the sale. OIG FF-AR-10-196

90. Project Financial System (PFS) segregation of duties. Southeast FSO contracting officer created and approved the same project payment of $244,046. Increases

chances for fraud. FY 2005 terminal dues incorrectly billed, costing the Postal Service $53,475. OIG FT-MA-09-002

91. The Postal Service should improve its management of Express Mail corporate account revenue. The monetary impact of revenue loss and funds put to better use was $6.2 million in 2011 and 2012 combined. OIG DP-AR-13-003

92. More private partnerships: transportation, digital mail processing, OIG IG Speech

93. Providing direct appropriations from Congress, GAO 5/20/09, 674T

VI. Pension Reform: 13 Proposals

94. Change pension benefits for new employees, GAO 9/6/11, 926T

95. Seek $6.9B FERS surplus, GAO 9/6/11, 926T

96. Administration: seek same but reimbursement amortized over 30 years, GAO 9/6/11, 926T

97. End FERS pension funding, $3B annually based on FY2012 payment, GAO-13-347T

98. The Postal Service being unfairly burdened for its share of the FERS pension obligation. OPM calculated a $6.8B surplus at end of FY2009. OIG FT-MA-10-001

99. Refund FERS overpayment, $3B, OIG HR-MA-12-001

100. Limit FERS annuity supplement to those subject to mandatory retirement. OIG HR-MA-12-001

101. Pension benefit obligations now funded at 105%, $13.1B overfunded ($1.7 billion CSRS and $11.4B FERS). By contrast federal government is 42% funded and military is 27% funded. The Postal Service has funded 50% of its future RHB. Use $85B of real property assets to fund remaining 50%, or $46B. OIG FT-MA-12-002

102. S&P 500 companies have median prefunding level in 2009 for pensions of 79% of liabilities. Federal government has funded combined FERS and CSRS at 41% of liabilities, and military's at 24%. Set the Postal Service prefunding for pensions at 80%, and RHB prefunding at 30%. Has effect of eliminating 2006 law mandate of $5.6B for RHB.OIG FT-MA-11-001

103. Early retirement offer in 2009 taken by 20,000 clerks and mail handlers, $350M savings, OIG RARC-WP-11-007

104. Increase employees' contributions to CSRS and FERS. OIG HR-MA-12-001

105. CSRS overpayment by Postal Service, $75B, OIG IG Speech

106. Repay shift in military pensions to Postal Service, OIG IG Speech

VII. Delivery Options: 16 Proposals

107. Six foreign posts examined all offer digital or hybrid options to physical mail delivery, GAO 2/11, 282

108. Hybrid mail system: send digitally, receive hard copy, 400 million pieces starting market potential; lost $4.1M in 2011-2012 by not adopting; could increase revenue $3.8 million/year in 2013 and 2014, OIG SM-MA-13-004

109. Expand cluster boxes, $4.5B annually as of 2011, 4/10, GAO-10-45,

110. End door-to-door delivery, several hundred million dollars, the Postal Service official at GCA 2013 winter meetings

111. Eliminate 33 city routes and transfer vehicles to rural delivery. Saves $250,110/$279,972 annually from operating efficiency. Reduces EMA costs from rural carriers using their own cars and assists in meeting vehicle provision in NRLCA agreement. OIG DR-AR-12-002

112. City delivery is largest cost center within the Postal Service. Budgeted overtime exceeded by 10.4 million hours in city delivery installation staffing. Reduces annual costs by $116.8M, OIG DR-AR-12-006

113. Reform USO to support deployment of broadband and voice in high-cost areas to ensure low-income Americans can afford it, and to boost adoption and utilization. Comprehensive lease agreement to provide the Postal Service facilities and land for expansion of broadband infrastructure. Adds $4.2 million annually to revenue stream. OIG DA-MA-12-002

114. Establish a new vehicle fleet purchase strategy instead of a "fix as fails" strategy, where maintenance costs now exceed replacement costs. OIG CI-AR-12-006

115. Reduce idle time and generate other efficiencies in delivery and transportation systems by adopting end-to-end GPS system. Vendors estimate a $191M—$435M ROI over three year contract. OIG DR-MA-11-003

116. Criticized postal management for not considering the impact of PRC savings estimate for 5-day delivery in its five year financial plan. OIG FT-MA-11-004

117. Potential annual revenue to the Postal Service from electrification of PJM's territory is $69.4M for 30,060 vehicles, or $154,657 for a minimum use of 67 electrified vehicles. OIG DA-WP-09-001

118. Decouple retail and delivery operations, OIG RARC-WP-11-009

119. "Co-opetition" in delivery, all deliveries via a single postal truck, green, OIG IG Speech

120. Universal home delivery at greatly reduced cost: use of evaluated routes, modes of delivery, to property line of cluster boxes, OIG IG Speech

121. Faster delivery, lighter packages, facilities throughout communities rather than edge of cities, OIG IG Speech

122. Rapid cross town delivery: Deliveries to include groceries, dry cleaning, wherever designated, OIG IG Speech

III. Other: 7 proposals

123. Review need for 74 district offices and 9 area offices, GAO 8/9/09 958-T

124. Reduce field admin offices, 4/10,GAO-10-455

125. Significant opportunities to reduce costs by consolidating its field structure. Close district offices that are within 50 miles of one another saves $33.6M annually. OIG FF-AR-10-224(R)

126. If Congress acts, it should possibly require the Postal Service to also act on issues within its control, 4/10, GAO-10-4

127. Reform Thrift Savings Plan contributions, $1B current FY2012 cost. GAO-13-347T

128. The Postal Service could save $13M in annual data costs by reducing manual data collection for RPW reports in favor of modifying existing automated processes. OIG CRR-AR-12-003

129. Increase postal independence from national budget considerations. Conform House PAYGO rule to Senate's. Shift to off budget the Postal Service share of CSRDF, and PSRHBF. Opt out of appropriations process or shift cost of free mail

for the blind and overseas voters to appropriate federal agencies and have them reimburse the Postal Service for postage, saving $100M annually. OIG ESS-WP-09-001

APPENDIX 4: FIFTY-FOUR PROPOSALS THE POSTAL SERVICE CAN ACT UPON BY ITSELF

NOTE: Some categorizations in right-hand column are left blank because the item is substantially identical with another item; cross-references are given. In some cases affecting employee compensation, benefits, tenure, etc., where legislation would be required, it is assumed that such legislation would eliminate any bargainable issues, and bargaining is not listed in the right-hand column.

List No.	Description	Categorizations
23	Eliminate employees through attrition: $1.3B annually 300,000 employees in four years	Legislation not required Bargaining not required
24	Reduce workforce through retirements	Legislation not required Bargaining not required
25	Offer early retirement incentives	Legislation not required Bargaining not required
26	Separation incentives – postmasters, mail handlers $542M in FY2012. Continue at current rate.	Legislation not required Bargaining not required
31	Labor out-transition services (training, job search, relocation)	Legislation not required Bargaining not required
40	Move more retail to stores, self-service	Legislation not required Bargaining not required
41	Offer parcel pickup at stores or 24-hr. lockers	Legislation not required Bargaining not required
42	Add retail locations other than post offices $5B of $18B already from other locations	Legislation not required Bargaining not required
43	Locate retail where/when customers are present	Legislation not required Bargaining not required
44	Reduce retail network	Legislation not required Bargaining not required
45	Close 12,000 retail facilities	Legislation not required Bargaining not required

46	Communication/outreach to inform public of increased access	Legislation not required Bargaining not required
47	Substitute alternatives for post offices; re-design usps.com site Reach 60% goal	Legislation not required Bargaining not required
48	Offer stamps through mail, Internet, stores	Legislation not required Bargaining not required
49	Sell unused space or release it to other U.S. agencies	Legislation not required Bargaining not required
51	Dispose of excess space, save utility, custodial costs On retail space. $348M annually	Legislation not required Bargaining not required
52	Reform leases which pay above market rent Up to $134M annual savings using #51 lease info	Legislation not required Bargaining not required
53	Pursue Retail Access Optimization Initiative [now Post Plan]	Legislation not required Bargaining not required
54	Sell the Postal Service real estate assets. $85B	Legislation not required Bargaining not required
55	Expand on-line platform to include hard-copy cards, invitations	Legislation probably not required Bargaining not required
56	Digital access through the Postal Service website	Legislation not required Bargaining not required
63	Accelerate closing of processing facilities to keep pace with volume decline	Legislation not required Bargaining not required
65	Relax delivery standards to facilitate plant closings $1.6B in FY2012 done of $4.1B total	Legislation not required Bargaining not required
67	Remove excess processing capacity	Legislation not required Bargaining not required
68	Close 300 processing plants	Legislation not required Bargaining not required
69	Relax FCM, Periodicals delivery standards to eliminate plants, machines, trips	Legislation not required Bargaining not required

70	Eliminate 135 P&DCs	Legislation not required Bargaining not required
71	"Right size" mail processing facilities	Legislation not required Bargaining not required
72	Outsource custodial, vehicle service driver positions. $675M annually	Legislation probably not required Bargaining required
73	Eliminate 10 CSBCS machines (obsolete recommendation)	Legislation not required Bargaining not required
74	Use less overtime in processing; improve mail handling, manual, and allied operations performance $969.5M annually	Legislation not required Bargaining possibly required
75	Improve UAA metrics and streamline UAA workflow. Cut costs 25%: $250 M annually	Legislation not required Bargaining not required
76	Simplify mail acceptance rules	Legislation not required Bargaining not required
77	Implement 55 various GAO revenue initiatives	Legislation not required Bargaining not required
79	Provide volume incentives for bulk mail	Legislation not required Bargaining not required
80	Increase revenue through new or enhanced products	Legislation not required Bargaining not required
88	Expand successful Supply Management Portfolio revenue generators. Over $17.2M annually based on 2008	Legislation not required Bargaining not required
89	Ensure evaluation of NSAs does not credit money-losing contracts with positive revenue. $24.1M from summer sale	Legislation not required Bargaining not required
90	Segregate duties so that same officer does not create/approve project; correct terminal dues billing. $53,000 from one example	Legislation not required Bargaining not required
91	Improve Express Mail corporate account management. $6.2M in 2011	Legislation not required Bargaining not required
109	Expand cluster box delivery. $4.5B	Legislation not required Bargaining not required

110	End door delivery. Several Hundred Million Dollars	Legislation not required Bargaining not required
111	Eliminate some city routes in favor of rural routes. $250,000—$280,000 for 33 city routes	Legislation not required Bargaining possibly required
112	Control over-budget overtime in city delivery. $116.8M annually	Legislation not required Bargaining not required
114	Establish new vehicle purchase strategy to replace "fix as fails"	Legislation not required Bargaining not required
115	Adopt end-to-end GPS system to reduce idle time, increase efficiency in delivery and transportation. $191/435 ROI	Legislation not required Bargaining not required
117	Adopt electric vehicles. $69.4M net added revenue annually over current repair costs, 30,000 vehicles	Legislation not required Bargaining not required
118	Decouple retail and delivery operations	Legislation not required Bargaining possibly required
119	Offer "co-opetition" in delivery; all carriers share Postal Service vehicle	Legislation not required Bargaining possibly required
121	Set up delivery facilities throughout communities rather than on edge of cities for faster delivery	Legislation not required Bargaining not required
123	Review need for 74 District, 9 Area offices	Legislation not required Bargaining not required
124	Reduce field administrative offices	Legislation not required Bargaining not required
125	Similar to 128-129; close District offices within 50 miles of each other. $33.6M annually	Legislation not required Bargaining not required
128	Reduce manual data collection for RPW in favor of modifying existing automated procedures. $13.2M	Legislation not required Bargaining not required

APPENDIX 5: SEVENTY-EIGHT PROPOSALS NOT REQUIRING COLLECTIVE BARGAINING
(TWENTY THREE NUMBERS IN BOLD REQUIRE OR MAY REQUIRE LEGISLATION)

NOTE: Some categorizations in right-hand column are left blank because the item is substantially identical with another item; cross-references are given. In some cases affecting employee compensation, benefits, tenure, etc., where legislation would be required, it is assumed that such legislation would eliminate any bargainable issues, and bargaining is not listed in the right-hand column.

List No.	Description	Categorizations
23	Eliminate employees through attrition. $17,500 savings per employee; $1.3B annually for 75,000 employees	Bargaining not necessarily required
24	Reduce workforce through retirements	Bargaining not required
25	Offer early retirement incentives	Bargaining not required
26	Separation incentives – postmasters, mail handlers. Repeat 2012 savings, $542M	Bargaining not required
31	Labor out-transition services (training, job search, relocation)	Bargaining not required
34	Reduce incentives to use leave, enforce leave management	For some
36	Observe officer salary cap. $110,011	Bargaining not required
39	[same as 25] + transfer FERS overpayment to the Postal Service for use in buyouts	Bargaining not required
40	Move more retail to stores, self-service	Bargaining not required
41	Parcel pickup at stores or 24-hr. lockers	Bargaining not required
42	Add retail locations other than post offices	Bargaining not required
43	Locate retail where/when customers are present	Bargaining not required
44	Reduce retail network	Bargaining not required
45	Close 12,000 retail facilities	Bargaining not required

46	Communicate/outreach to inform public of increased access	Bargaining not required
47	Substitute alternatives for post offices; re-design usps.com site	Bargaining not required
48	Offer stamps through mail, Internet, stores	Bargaining not required
49	Sell unused space or release it to other U.S. agencies	Bargaining not required
51	Dispose of excess space, save utility, custodial costs. $348M annually, $3.48B over 10 yrs.	Bargaining not required
52	Reform leases which pay above market rent. $134M based on stats in #51	Bargaining not required
53	Pursue Retail Access Optimization Initiative [now Post Plan]	Bargaining not required
54	Sell the Postal Service real estate assets. $85B	Bargaining not required
55	Expand on-line platform to include hard-copy cards, invitations	Bargaining not required
56	Digital access through the Postal Service website	Bargaining not required
58	Use post offices to complement the Postal Service digital platform, with human staff to help interface with other U.S. agencies	Bargaining possibly required
59	Provide emergency government services, interactions	Bargaining not required
60	Offer community bulletin boards, licenses, permit applications, citizen polling/opinion gathering	Bargaining not required
61	Set up centers of continuous democracy	Bargaining not required
63	Accelerate closing of processing facilities to keep pace with volume decline	Bargaining not required
65	Relax delivery standards to facilitate plant closings	Bargaining not required
67	Remove excess processing capacity	Bargaining not required
68	Close 300 processing plants	Bargaining not required
69	Relax FCM, Periodicals delivery standards to eliminate plants, machines, trips. $4.1B	Bargaining not required
70	Eliminate 135 P&DCs	Bargaining not required
71	"Right size" mail processing facilities	Bargaining not required
73	Eliminate 10 CSBCS machines (obsolete recommendation)	Bargaining not required

74	Use less overtime in processing; improve mail handling, manual, and allied operations performance. $969.5M	Bargaining possibly required
75	Improve UAA metrics and streamline UAA workflow. 25% improvement, $250M	Bargaining not required
76	Simplify mail acceptance rules	Bargaining not required
77	Implement 55 various GAO revenue initiatives	Bargaining not required
79	Provide volume incentives for bulk mail	Bargaining not required
80	Increase revenue through new or enhanced products	Bargaining not required
81	Offer nonpostal services (photocopy, fax, passport, Internet, ATMs, etc.)	Bargaining not required
82	Offer nonpostal services including e-mail delivery, financial services, tax payment acceptance, etc. (from review of foreign posts)	Bargaining not required
83	Increase proportion of revenue from nonpostal services	Bargaining not required
84	[Similar to 83]	Bargaining not required
86	Copy corporate formal innovation processes; internal or partnership implementation	Bargaining not required
87	Pricing structure complex; methods of insuring cost recovery lag technological potential; exploit flexibilities in statute, formulate strategic plan for doing so	Bargaining not required
88	Expand successful Supply Management Portfolio revenue generators Over $15.3M	Bargaining not required
89	Ensure evaluation of NSAs does not credit money-losing contracts with positive revenue	Bargaining not required
90	Segregate duties so that same officer does not create/approve project; correct terminal dues billing. $54,000 loss in SE FSO	Bargaining not required
91	Improve Express Mail corporate account management. $6.2M	Bargaining not required
92	Increase the Postal Service -private sector partnerships	Bargaining possibly required
93	Direct appropriations from Congress	Bargaining not required
95	FERS surplus transfer to the Postal Service. $6.9B	Bargaining not required
96	Amortize FERS surplus over 30 years	Bargaining not required

	(Administration proposal)	
97	End FERS pension funding. $3B annually	Bargaining not required
99	Refund FERS overpayment	Bargaining not required
100	Limit FERS annuity supplement to those subject to mandatory retirement	Bargaining not required
101	The Postal Service pension benefits over-funded; use real estate assets to fund the 50 percent of retiree health benefits still un-funded	Bargaining not required
102	Set the Postal Service pension funding at 80 percent, retiree health benefits at 30 percent; eliminates PAEA annual prefund-ing payment. $5.6B	Bargaining not required
103	Continue early retirement offers to clerks, mail handlers. $350M per 20,000 clerks	Bargaining not required
109	Expand cluster box delivery. $4.5B	Bargaining not required
110	End door delivery	Bargaining not required
111	Eliminate some city routes in favor of rural routes. $250,000 per 33 city routes	Bargaining possibly required
112	Control over-budget overtime in city de-livery. $116.8M	Bargaining not required
113	Reform USO to support the Postal Service provision of broadband in high-cost areas. $4.2M added revenue	Bargaining not required
114	Establish new vehicle purchase strategy to replace "fix as fails"	Bargaining not required
115	Adopt end-to-end GPS system to reduce idle time, increase efficiency in delivery and transportation. $191M ROI	Bargaining not required
117	Adopt electric vehicles. $69.4M added net revenue for 30,060 vehicles	Bargaining not required
118	Decouple retail and delivery operations	Bargaining possibly required
119	Offer"co-opetition" in delivery; all carriers share Postal Service vehicle	Bargaining possibly required
121	Offer delivery facilities throughout com-munities rather than on edge of cities for faster delivery	Bargaining not required
123	Review need for 74 District, 9 Area offices	Bargaining not required
124	Reduce field administrative offices	Bargaining not required

125	Similar to 128-129; close District offices within 50 miles of each other. $33.6M	Bargaining not required
128	Reduce manual data collection for RPW in favor of modifying existing automated procedures. $13M annually.	Bargaining not required
129	Increase the Postal Service independence of Federal budget (various items). $100M annually	Bargaining not required

APPENDIX 6: FIFTY-NINE PROPOSALS NOT REQUIRING LEGISLATION

(CATEGORIZATIONS IN BOLD REQUIRE OR MAY REQUIRE COLLECTIVE BARGAINING)

NOTE: Some categorizations in right-hand column are left blank because the item is substantially identical with another item; cross-references are given. In some cases affecting employee compensation, benefits, tenure, etc., where legislation would be required, it is assumed that such legislation would eliminate any bargainable issues, and bargaining is not listed in the right-hand column.

List No.	Description	Categorizations
22	Correct OPM inflation estimate	Legislation not required
23	Eliminate employees through attrition	Legislation not required
24	Reduce workforce through retirements	Legislation not required
25	Offer early retirement incentives	Legislation not required
26	Separation incentives – postmasters, mail handlers	Legislation not required
31	Labor out-transition services (training, job search, relocation)	Legislation not required
40	Move more retail to stores, self-service	Legislation not required
41	Officer parcel pickup at stores or 24-hr. lockers	Legislation not required
42	Add retail locations other than post offices	Legislation not required
43	Locate retail where/when customers are present	Legislation not required
44	Reduce retail network	Legislation not required
45	Close 12,000 retail facilities	Legislation not required
46	Communication/outreach to inform public of increased access	Legislation not required
47	Substitute alternatives for post offices; re-design usps.com site	Legislation not required
48	Offer stamps through mail, Internet, stores	Legislation not required
49	Sell unused space or release it to other U.S. agencies	Legislation not required

50	Match retail hours to workload	Legislation not required
51	Dispose of excess space, save utility, custodial costs	Legislation not required
52	Reform leases which pay above market rent	Legislation not required
53	Pursue Retail Access Optimization Initiative [now Post Plan]	Legislation not required
54	Sell the Postal Service real estate assets	Legislation not required
55	Expand on-line platform to include hard-copy cards, invitations	Legislation probably not required
56	Digital access through the Postal Service website	Legislation not required
63	Accelerate closing of processing facilities to keep pace with volume decline	Legislation not required
65	Relax delivery standards to facilitate plant closings	Legislation not required
67	Remove excess processing capacity	Legislation not required
68	Close 300 processing plants	Legislation not required
69	Relax FCM, Periodicals delivery standards to eliminate plants, machines, trips	Legislation not required
70	Eliminate 135 P&DCs	Legislation not required
71	"Right size" mail processing facilities	Legislation not required
72	Outsource custodial, vehicle service driver positions. $675M annually	Legislation probably not required
73	Eliminate 10 CSBCS machines (obsolete recommendation)	Legislation not required
74	Use less overtime in processing; improve mail handling, manual, and allied operations performance	Legislation not required
75	Improve UAA metrics and streamline UAA workflow	Legislation not required
76	Simplify mail acceptance rules	Legislation not required
77	Implement 55 various GAO revenue initiatives	Legislation not required
79	Provide volume incentives for bulk mail	Legislation not required
80	Increase revenue through new or enhanced	Legislation not required

	products	
88	Expand successful Supply Management Portfolio revenue generators	Legislation not required
89	Insure evaluation of NSAs does not credit money-losing contracts with positive revenue	Legislation not required
90	Segregate duties so that same officer does not create/approve project; correct terminal dues billing	Legislation not required
91	Improve Express Mail corporate account management	Legislation not required
94	Change pension benefits for new employees	Legislation not required
109	Expand cluster box delivery	Legislation not required
110	End door delivery	Legislation not required
111	Eliminate some city routes in favor of rural routes	Legislation not required
112	Control over-budget overtime in city delivery	Legislation not required
114	Establish new vehicle purchase strategy to replace "fix as fails"	Legislation not required
115	Adopt end-to-end GPS system to reduce idle time, increase efficiency in delivery and transportation	Legislation not required
117	Adopt electric vehicles	Legislation not required
118	Decouple retail and delivery operations	Legislation not required
119	Implement "Co-opetition" in delivery; all carriers share Postal Service vehicle	Legislation not required
121	Delivery facilities throughout communities rather than on edge of cities for faster delivery	Legislation not required
123	Review need for 74 District, 9 Area offices	Legislation not required
124	Reduce field administrative offices	Legislation not required
125	Similar to 128-129; close District offices within 50 miles of each other	Legislation not required
128	Reduce manual data collection for RPW in favor of modifying existing automated procedures	Legislation not required

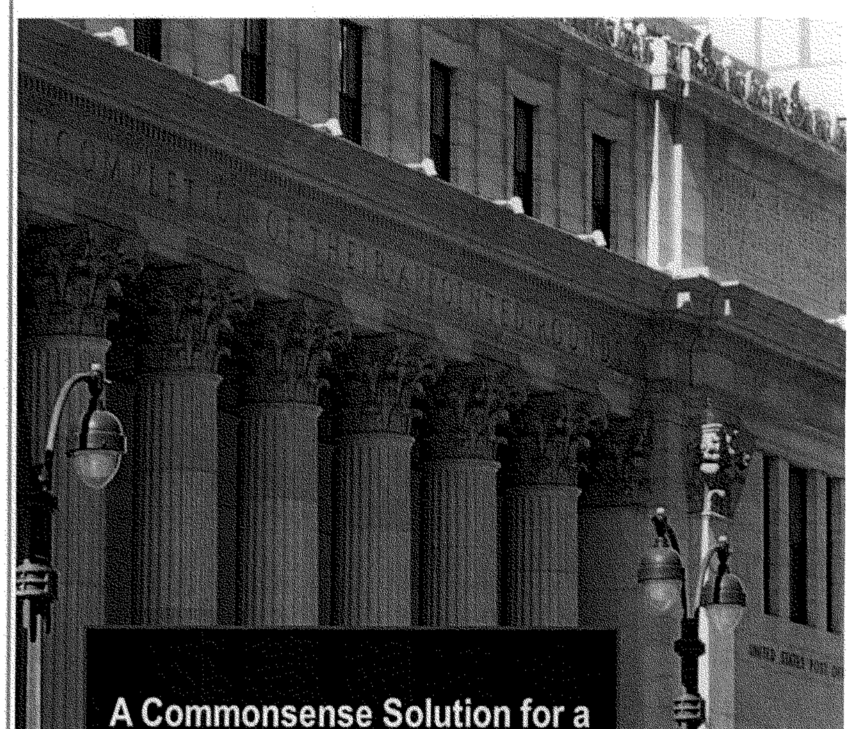
APPENDIX 7: FORTY-FOUR PROPOSALS REQUIRING COLLECTIVE BARGAINING OR LEGISLATION

NOTE: Some categorizations in right-hand column are left blank because the item is substantially identical with another item; cross-references are given. In some cases affecting employee compensation, benefits, tenure, etc., where legislation would be required, it is assumed that such legislation would eliminate any bargainable issues, and bargaining is not listed in the right-hand column.

List No.	Description	Categorizations
1	Cut health benefit contribution to 72% government level	Bargaining or legislation required No service effect No rate effect
2	[same as 1]	
3	Transfer $42B health care assets from Treasury to the Postal Service Fund	Legislation required No service effect No rate effect
4	Reduce life insurance contribution to 33% government level	Bargaining required No service effect No rate effect
5	Reduce the Postal Service health, life contribution rate for actives	Bargaining required No service effect No rate effect
6	Pay-as-you-go health benefit funding	Legislation required No service effect No rate effect
7	Actuarial approach to retiree health benefit funding	Legislation required No service effect No rate effect
8	Prefund retiree health benefits at 30% of liability	Legislation required No service effect No rate effect
9	Reduce RHB prefunding annual requirement to <$5.4B	Legislation required No service effect No rate effect
10	Reduce or eliminate RHB prefunding annual requirement	Legislation required No service effect No rate effect
11	The Postal Service to sponsor own health plan	Legislation required No service effect No rate effect

12	The Postal Service to leave FEHB + Close 48% of processing plants	Legislation required (FEHB) No service effect necessary No rate effect
13	Administration proposal on RHB pre-funding	Legislation required No service effect No rate effect
14	S. 1789 approach on RHB prefunding	Legislation required No service effect No rate effect
15	[same as 6]	
16	H.R. 2309 modified approach on RHB prefunding	INCREASES DEFICIT
17	End RHB prefunding; use existing funds	Legislation required No service effect No rate effect
18	[same as 11]	
19	Use pension, health overfunding	Legislation required No service effect No rate effect
20	Tie benefits to inflation (COLA)	Legislation probably required Bargaining required No service effect No rate effect
21	Repay shift in military pensions	Legislation probably required No service effect No rate effect
27	Reform workers' compensation for re-tirement eligible	Legislation required No service effect No rate effect
28	Two tiered wage system (new hires vs. current employees)	Bargaining required No service effect No rate effect
29	Require arbitrators to recognize the Postal Service's financial condition	Legislation required No service effect No rate effect
30	Outsource work where cost-effective	Bargaining required No service effect No rate effect
32	Eliminate layoff protection to permit workforce reduction	Bargaining required No service effect No rate effect
33	Reduce IS, security, stamp management costs; align benefits with other agencies	Bargaining required No service effect No rate effect
35	Eliminate Christmas supplemental hours, related overtime	Bargaining may be required No service effect

		No rate effect
37	[same as 24 – 26]	
38	Change retirement formula to use high 5 years as basis	Legislation required No service effect No rate effect
57	E-mail box interfaced with physical mail-box	Legislation required No service effect No rate effect
62	Digital services less space and labor in-tensive than current services	Legislation possibly required Bargaining probably required No service effect necessary No rate effect
65	Relax delivery standards to facilitate plant closings	Service effect No rate effect
66	Set up BRAC-type mechanism to facili-tate plant closings	Legislation required No service effect necessary No rate effect
78	The Postal Service /McKinsey report identify 100 cost/volume/revenue initia-tives	[Indeterminate]
85	Expand electronic nonpostal services; possibly adjust the Postal Service wage structure to make feasible	Legislation required Bargaining possibly required No service effect No rate effect
104	Increase employee contributions to CSRS and FERS	Legislation required No service effect No rate effect
105	Return CSRS overpayment to the Postal Service	Legislation required No service effect No rate effect
106	[Same as 21]	
107	Offer digital or hybrid alternatives to hard-copy mail delivery (cf. foreign posts)	Legislation required Bargaining possibly required Service effect Possible rate effect
108	[Similar to 111]	
122	Rapid cross-town delivery. To include groceries, dry cleaning, as well as mail	Legislation required Bargaining probably required Service effect Rate effect possible
126	Congressional requirement that the Postal Service act on issues within its control, as part of any legislation	Legislation required Bargaining possibly required Service effect possible Rate effect possible
127	Reform Thrift Savings Plan contribution	Legislation required Bargaining possibly required
		No service effect No rate effect



A Commonsense Solution for a Stronger Postal Service

Greeting Card Association

July 2013

[1] On Friday, May 10th, the Postal Service released quarterly data showing that the deficit is shrinking by comparison with SPLY, the same period last year. Thus, while its cumulative debt is still rising, the level of its annual operating deficit may not be any longer. Source: the Postal Service, Quarter II, 2013 Financial Report, http://about.usps.com/who-we-are/financials/financial-conditions-results-reports/fy2013-q2.pdf, page 2.

[2] Because of small sample sizes, one must assume the deficits to be normally distributed to conduct these statistical tests.

[3] That includes missing two years of RHB pre-funding, \$5.5 billion for 2011 and 2012 or \$11.1 billion. The Postal Service reports the \$5.5 billion from 2011 in its 2012 operating statement because Congress "deferred" payment of that until August 2012. However, the 2011 missed payment is a debt and good accounting practice would place that on a balance sheet, not the Postal Service's 2012 operations statement.

[4] A fourth and final problem with the Postal Service deficit forecasts concerns how, or whether, the grand claims it makes annually on cost cuts achieved are factored in. The claims lack consistency. The FY2007 cost savings made from two sources are both \$1.2 billion, but the remaining years are substantially different. The Postal Service claims every year that it has cut billions of dollars in costs that year alone, \$1.2 billion, FY2007; \$2 billion, 2008; \$6.1 billion, 2009; \$3 billion, 2010; \$1.4 billion, 2011; \$1.1 billion, 2012. (Source: the Postal Service, as noted in GAO-13-347T, p. 2). The annualized labor cost savings noted in the Postal Service's latest five year plan, Plan to Profitability, 5 Year Business Plan, February 16, 2012 are: \$1.2 billion, FY2007; \$3.2 billion, 2008; \$9.3 billion, 2009; \$12.3 billion, 2010; \$13.7 billion, 2011; \$16.2 billion, 2012. (See 2012 Plan, p. 2)

[5] "Balancing the Postal Service's Budget with Six Day Delivery: A Set of Options," Greeting Cards Association, 10/2011

[6] Letter from Mary Anne Gibbons, the Postal Service General Counsel, to Hon. Claire McCaskill, March 22, 2013, p. 2.

[7] Board of Governors, the Postal Service, Statement from the U. S. P. S. Board of Governors,

[8] The GAO has argued, apparently persuasively, against the Postal Service and OIG's argument that it has overpaid postal contributions to the CSRS by \$75 billion and that that money should be refunded to the Postal Service. Accordingly, we do not discuss this as a viable part of deficit reduction options, #105.

BEFORE THE

COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

"OUTSIDE THE BOX: REFORMING AND RENEWING THE POSTAL SERVICE,
PART I – MAINTAINING SERVICES, REDUCING COSTS, AND INCREASING REVENUE THROUGH INNOVATION AND MODERNIZATION"

SEPTEMBER 19, 2013

TESTIMONY OF

JERRY CERASALE
SENIOR VICE PRESIDENT, GOVERNMENT AFFAIRS
DIRECT MARKETING ASSOCIATION, INC.
ON BEHALF OF
AFFORDABLE MAIL ALLIANCE
COALITION FOR A 21ST CENTURY POSTAL SERVICE
DIRECT MARKETING ASSOCIATION

Jerry Cerasale
Senior Vice President, Government Affairs
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Good morning, Senator Carper, Senator Coburn and members of the Committee, I am Jerry Cerasale, Senior Vice President for Government Affairs of the Direct Marketing Association, and I thank you for the opportunity to appear today on behalf of a united Postal Service customer community including the Affordable Mail Alliance, the Coalition for a 21st Century Postal Service, all the major postal customer trade associations, and the paper, printing and mail technology industries. Together, we are a $1.3 trillion industry that employs nearly 8 million private sector workers, and constitutes some 9% of GDP.

The Postal Service remains a vital communications and distribution channel for our nation's economy and the linchpin of the enormous industry which relies upon it. Yet, the Postal Service continues to struggle financially. Legislative change is indispensable.

As you know, taxpayers do not support the Postal Service. Rather, it is the business, nonprofit, and other mailers whose decisions to purchase postage pay the bills of the Postal Service. They account for approximately 80% of mail volume in all classes of mail and contribute 90% of the revenue of the U.S. Postal Service. Yet our industries have lost more than one million jobs since 2007. Many more are at stake

So, we are very pleased to have been invited to testify before you today. Given the urgency of the Postal Service's situation, we are encouraged that the Chairman and Ranking Member of this Committee remain invested in postal reform; we appreciate your leadership on this vital matter. As Senator Coburn stated, S. 1486 is a draft that hopefully would generate discussion on postal reform. It certainly has. The mailing industry stands ready to work with this Committee and the Congress to adopt legislation that continues a Postal Service supported by affordable and predictable postage rates upon which American citizens, our economy and the millions of employees in our industry rely.

We believe that the draft contains a number of constructive provisions that will be very useful to stabilizing the Postal Service's financial situation. Unfortunately, it also contains provisions that are so detrimental to the mailing industry and its supply chain that we must oppose the bill if included: 1) changes to the rate cap established under the

Postal Accountability and Enhancement Act of 2006 (PAEA); and 2) unrestricted, unchecked power handed to the Postal Service Governors to set rates.

As a bottom line, it is important to recognize that postage is not a tax. No one can force anyone to buy postage and mail. In today's competitive world, the market will be determinative. Raise postage rates too high, i.e., beyond inflation, and volume will suffer substantially.

Let me address a number of the specifics in the bill.

Health Benefits

PAEA has required postal customers to fund future postal retiree health benefits with a steep 10-year payment schedule averaging approximately $5.5 billion per year. As you know, the Postal Service has defaulted on these payments for the last two years and likely will default on a third payment at the end of this month. We believe the 40-year payment schedule for retiree health benefits contained in S. 1486 represents an appropriate solution. Such a schedule was in effect in 1971 for postal pensions under the Civil Service Retirement System and proved to be very successful.

The health benefit issue for the Postal Service is not confined to postal retirees. We have learned from the Postmaster General that the Postal Service and its employee organizations are negotiating a new health benefit program for postal employees and retirees within the Federal Employees Health Benefit Program run by OPM. Potential savings from any agreement could eliminate virtually all of the ~$50 billion unfunded retiree health benefit obligation of the Postal Service. It would also reduce the current employee annual obligation as well. We understand that any new program would cover only postal employees and retirees, would require those over 64 to enroll in Medicare Parts A, B and D, would mandate that OPM require the insurance companies in the new program to establish a Medicare Part D supplemental plan, and would mandate that OPM establish a postal blended rate for the new program. We encourage the Service and its employee organizations to reach an accord. Similarly, we support the principles in S. 1486 to create a postal health program and ask that any bargained agreement be included within the bill.

Postal Pensions

Postal customers, through the postage rates they pay, have been funding Postal Service employee pensions since July, 1971. Recently, the Office of Personnel Management (OPM) determined that postal customers have overfunded pension obligations for postal retirees under the Federal Employee Retirement System (FERS). That overpayment is in the billions of dollars, which means that the mailing community has contributed approximately 90% of those overpaid billions.

While customers should fund pension benefits for postal employees, they should not overfund them. The actual amount of the overfunding depends upon interest rates, timing and employee complement characteristics. S. 1486 would provide that postal employee characteristics be used to calculate any over funding or under funding of the FERS account, and that overfunded amounts be returned to USPS. We support both changes.

Postage

We have grave concerns about the rate setting provisions in S. 1486. Section 301 of the bill would grant the Board of Governors unilateral authority to set postage rates with an after-the-fact review through a weak complaint process at the Postal Regulatory Commission (PRC). This change prompts several serious issues:

- The after-the-fact complaint process at the Commission has no time limit, so rates could well go into effect long before a decision is reached – some complaint cases have taken years – and making the most appropriate remedy, i.e., refunds, completely unworkable: To whom would they go, and how would the Postal Service charge mailers who had underpaid in reliance upon incorrect rates?
- The burden of proof would shift to mailers, and the process would resemble the burdensome, expensive litigation wisely cast aside by Congress in PAEA;
- Since USPS holds a statutory monopoly over the distribution of Market Dominant products, the absence of a before-the-fact check invites abuse, even if inadvertent, providing ample reason why a more objective body should determine whether and how the ratesetting system should be updated; and

- Since the Postal Service is exempt from the antitrust, tax and other laws at both the federal and state levels, it should not in its Market Dominant categories be granted rate authority comparable to a business entity in a competitive environment

We are not aware of any other industry where Congress has granted the Board of an organization, having a statutory monopoly over a product and the delivery receptacle of that product, unilateral pricing authority on those products. We urge you not to create an unprecedented and virtually unregulated monopoly over letter mail that affects millions of American jobs, thousands of American organizations, and millions of beneficiaries or charitable causes. We do not believe this is good public policy, good for the economy or good for all who depend on affordable mail delivery.

For us, the CPI price cap on market dominant classes of mail remains a critical piece of any postal rate setting. The cap assures certainty and predictability in postage increases, leading to predictable mailer planning. Also, the cap is the incentive for the Postal Service to innovate, streamline operations and reduce costs. Without the cap, raising postage higher than inflation could easily become the norm during difficult times. We believe that the significant streamlining in operations that the Postal Service has already achieved is, to a large extent, due to the CPI cap on postage. Removing it would be a detriment to the Postal Service as short-term revenue increases would trump long-term mail volume retention. We are aware of studies that indicate mail is not price elastic—that mail would not leave the system due to postage increases. Executives of our members tell us otherwise. Technological changes are enormous, rapid and are coming at an ever increasing rate. They have, in fact, been gamechangers in the marketplace. They offer mailers new avenues to communicate with, and distribute to, current and potential customers and donors. Let me offer a few illustrations.

In Standard Mail, an executive in charge of a marketing campaign typically will review the predicted returns on investment (ROIs) from all of the options available, and distribute the company's available promotional funding according to the best advantage of that campaign. That executive will review the comparative ROIs frequently, sometimes on a weekly or even daily basis, and adjust among them as indicated. If postage rates go up, the ROI on mail empirically, and relative to the other avenues of communication, will change for the worse. Adjustments to reflect that, i.e., shifting from mail to other options, will occur. Moreover, those adjustments would especially reduce tprospecting mail—mail seeking new customers and donors—which has the lowest ROI. Thus, investment in the future would be the first mail to be eliminated harming the future viability of the Service.

In Periodicals Mail, higher postage rates would increase the economic pressure to move to digital delivery and to seek other forms of physical delivery of the product. The likelihood of higher than inflation postage increases will increase those efforts as the assurance of predictable postage increases is eliminated.

In First Class, the case is even more straightforward. On average, according to mailing executives, of every dollar spent on business First Class mail, paper, printing, content and other expenses total 35 cents. Postage is 65 cents. With printing costs having declined, and paper costs barely held even, over the past decade (in contrast to the steady upward track of postage), there is only one place to go if postage goes up—out of the mail and online. Ten years ago, if a mailing executive advised his or her Chief Financial Officer that the price of mail was going up, s/he would receive a matching boost of funds. Today, with other options available, the mailing executive will simply be directed to live within the existing budget. The result: more mail diverted online.

There has been a fairly steady march out of the mail and online. But all the First-Class Mail that could leave has not. Companies vary in how much mail has been taken out of the system. The industry rule of thumb is that roughly 25 – 27% of recipients will insist on continued paper communications. For most larger mailers 15% to 20% of First-Class Mail has been shifted to digital (granted for some, it can be as high as 55 or 60%) That leaves a very substantial spread between mail actually withdrawn and mail that could be withdrawn—a very substantial volume of mail.

Higher postage gives mailers an incentive to choose less expensive alternatives, and induces them to give incentives to their customers to accept digital rather than paper communications. Once a customer account is gone from paper, it's gone; it's not coming back. That will mean the loss not only of statements and bill payments, but several promotional pieces per year per account.

The CPI cap is a necessary provision for the future of the Postal Service and the customers it serves. The mailing industry includes suppliers to mailers, such as printers, paper manufacturers and technology providers. Those suppliers are a marketing team for the U.S. Mail since as mail volume grows, their business grows. Those suppliers tell us that even the possibility of a greater than inflation postage increase makes it much more difficult for them to "sell the mail." Postage stability is a key to finding new volume and retaining current volume. Without predictability in postage, the digital world of communications becomes more and more inviting.

In May, 2007, catalog mailers received a double digit postage increase. Catalog volumes plummeted 23 percent in the next year—a year in which other Standard Mail volume grew. Moreover, catalog postage revenue for the Postal Service, even with the double digit postage increase, dropped by 11 percent. Why? Contrary to the mail elasticity studies, catalog mail volume dropped by more than the postage increase. Why have those studies not picked up today's higher price elasticities? Recent rate increases have been limited to inflation. Postage increases above the rate of inflation may not be accurately explained by those studies. That can prove to be dangerous.

Prior to the 2007 double digit catalog postage increase, the Postal Service Board approved a significant purchase of flat-shaped mail processing equipment to improve the productivity of processing that mail, which includes catalogs. Sadly, the 2007 postage increase reduced flat-shaped mail volume to the extent that those flat-shaped mail processing machines could not and cannot be operated efficiently—there is not enough mail volume. These events created a significant amount of excess flat-shaped mail processing capacity. We urge Congress not to repeat this miscalculation. Postage increases above inflation will drive out significant mail volume.

Those factors are why a united postal customer community will vigorously fight any efforts of the Postal Service to break the CPI cap by filing an exigency postage rate case. The Congress should oppose it as well. An exigency increase will result in a short-term infusion of cash, as mailers adjust their plans to take more volume out of the system. We cannot gamble the future of the Postal Service on that potential short-term influx of cash. The stakes are too high.

I want to return to the excess flat-shaped mail processing capacity issue for a moment. There have been numerous and repeated calls to raise postage for "underwater" classes and products of mail,—eliminating any "underwater" or below-cost classes and products of mail. Those classes and products predominantly are flat-shaped mail. We believe that the underwater nature is due to Postal Service excess capacity. Last Congress the Senate passed S. 1789 that contained a provision asking for a study of the effect of excess capacity of the costs of flat-shaped mail. We believe that was a good compromise that should be continued.

New Postal Products

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

As far as non-postal products are concerned, some caution is required. Postal Service employee expertise is collecting, sorting, transporting and delivery physical mail. Non-postal products do not fall within their expertise, and efforts to gain that expertise will reduce focus on efforts to improve performance dealing with postal products. If there is a discernible market need that is not being adequately met, the Service should find private sector business partners who can provide the requisite expertise. Moreover, the Service should be limited from unfairly competing with private sector businesses already offering products or services the Service may be considering providing.

The Service should be able to use experimental authority to test new products, some of which may fail. The Service should not be constrained with a short-term no-loss oversight of experimental offerings.

Postal Facilities

We commend the Postal Service for its efforts to right-size its processing and transportation network. They have accomplished a significant cost reduction in a short period of time without service disruptions. We support completion of these efforts. We do not understand the 2-year moratorium in S. 1486 in light of the significant closings that have already occurred without harming service. The financial viability of the Postal Service depends upon the ability of management to adjust its networks to meet the changing needs in the marketplace and mail volume. They should be granted the authority to accomplish that task.

Delivery Point Modernization

Since studies have indicated that there are significant cost savings to delivery point modernization, we believe that the Service should further assess it and the attitudes of citizens concerning any home delivery changes, and report to Congress within a reasonable period of time.

Delivery Days

Elimination of Saturday delivery has been very controversial; the mailing industry and its supply chain remains split over their willingness to accept a 5-day delivery week. We appreciate the compromise in S. 1486 that helps facilitate the growth of the Postal Service's most promising segment, parcels. We view the compromise as a constructive basis for further discussion.

The Postal Service should focus on increasing mail volume. It first should look very aggressively at removing barriers for customers to use the mail. In the past few years the Postal Service has placed many new requirements on business customers that necessitated reengineering the address placement on catalogs, new barcoding, and new demands on customers' IT systems in hopes of reducing costs of the Postal Service. Sadly, those costs keep rising at the same time the requirements increase the costs for mailers. And, in fact, mailers do not differentiate these "compliance" costs from rate increases: it all makes mailing more expensive and less competitive. All of those requirements should be reexamined by the Service in constant consultation with its customers.

In conclusion, postal reform legislation remains as urgent as it has been for the past several years. Postal Service financial uncertainty and potential exigent (above inflation) postage increases are undermining mailers' confidence in this communications channel. This threatens the long-term financial viability of a $65 billion per year entity. We urge you to act with all deliberate speed.

But we reiterate that changing the CPI cap and granting unrestricted, and unchecked, authority to the Board of Governors to increase postage rates are both unacceptable to the mailing community and its suppliers. We believe those provisions will drive away business and damage both the industry and the Postal Service. So, we encourage you to build upon the many positives in S. 1486, negotiated health benefit reform prime among them, to develop reform that will bring stability to postal finances without pushing volume out of the system and raising the specter of a bailout. Our community looks forward to working with you on this endeavor.

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

TESTIMONY OF

SETH WEISBERG,

CHIEF LEGAL OFFICER,

STAMPS.COM

OUTSIDE THE BOX: REFORMING AND RENEWING THE POSTAL SERVICE, PART I – MAINTAINING SERVICES, REDUCING COSTS AND INCREASING REVENUE THROUGH INNOVATION AND MODERNIZATION

HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS COMMITTEE

U.S. SENATE

SEPTEMBER 19, 2013

INTRODUCTION

My name is Seth Weisberg, and I am the Chief Legal Officer of Stamps.com, a leading PC Postage company. In this written version of my testimony, I first provide background information about Stamps.com and the PC Postage industry, and then I discuss today's topic: How innovation and modernization can allow the Postal Service to maintain and improve services, reduce costs, and increase revenues.

BACKGROUND INFORMATION

PC Postage is Internet based computer software that allows customers to print their own postage using their existing computer and printer. Our software has developed to provide a full suite of modern cutting edge tools to mailers and shippers. We provide continuous product improvements and high touch customer support, all at negligible cost to the Postal Service. Stamps.com is the leading vendor, along with Endicia, in the US Postal Service PC Postage® program and the leading vendor in the USPS Customized Postage program with our PhotoStamps® product. Stamps.com specializes in bringing cutting edge Internet technology to mailers and shippers, and we currently serve over 500,000 registered PC Postage customers that are primarily small businesses from a cross-section of industries. Some sample customer testimonials are available at http://www.stamps.com/postage-online/testimonials/. In 1999, Stamps.com became the first company to offer a commercial software-only PC Postage solution, enabling customers for the first time ever to print real USPS postage from any Internet-connected PC and standard printer.

Customer adoption of PC Postage has grown rapidly since it was introduced, and has brought in new mail volume that would otherwise have gone to postal competitors. Just six years ago, PC Postage accounted for roughly $250 million in annual postage sales. In 2012, Stamps.com and Endicia together accounted for over $2.85 billion in postage sold. Stamps.com postage growth alone was more than 70%

year over year. That is right, growth even through the heart of the recession. The substantial majority of postage purchased through PC Postage is used on Priority Mail and Express Mail products – the classes of mail that provide USPS with its highest level of contribution above direct cost. Virtually all the Priority and Express (domestic & international) growth surge in recent years is generated through the PC Postage industry channel. A recent Postal Service study showed revenue through the industry PC Postage channel costs $0.02 per $1.00 of revenue compared to $0.47 per $1.00 through a USPS owned retail outlet.

PC Postage provides many benefits to the USPS, including at least six items: (1) PC Postage produces a secure, sender-identifiable mail piece which is important for security against biological or other attacks because it reduces the amount of anonymous mail in the mail stream; (2) PC Postage automatically checks addresses reducing the cost to the USPS of undeliverable-as-addressed mail; (3) PC Postage can adapt quickly to changes in rates and classifications; (4) the PC Postage product and industry help to educate postal customers on Postal Service requirements; (5) PC Postage mail includes intelligent mail barcodes optimized to work with current and future USPS mail processing systems; and (6) PC Postage provides Postal customers with cutting edge technology without the Postal Service having to pay for research, development, support or maintenance.

PC Postage directly supports several long term USPS initiatives, including expanding access to postal services, using technology to enhance value, and enhancing package services. In addition, as barcodes become increasingly more reliably scanned in mail processing centers, PC Postage is even more valuable in terms of real-time data for the USPS that can be used to improve tracking and tracing capability, to improve revenue protection, to enhance mail security and deter terrorism, and to provide valuable real-time data on customer mailing & shipping behavior.

In 2004, Stamps.com invented and launched PhotoStamps®, a new form of PC Postage through which consumers or businesses turn digital photos, designs or images into valid US postage. PhotoStamps is used as regular postage to send greeting cards, letters, postcards or packages. We estimate that as much as 50% of the postage revenue from PhotoStamps is brand new revenue for the Postal Service as customers substitute from electronic communication back to physical mail, increase their usage of the mail, or purchase PhotoStamps for collector's items or gifts that never get used on mail. In addition, 72% of PhotoStamps customers have stated that PhotoStamps makes mail more exciting to send, 55% say PhotoStamps make mails more exciting to receive, and 56% say PhotoStamps makes their perception of the US Postal Service more positive or much more positive.

In 2008, we launched an Enterprise service targeted to organizations with multiple geographic locations. It features enhanced reporting that allows a central location such as a corporate headquarters greater visibility and control over postage expenditures across their network of locations. Customers such as government agencies increasing their use of small and home offices are attracted to our corporate enterprise solution based on our dramatically lower cost of ownership and visibility into individual employee activity from our sophisticated front-end reporting tool with real time data, improved web-based postage management tools, and enhanced web-based financial and administrative controls for central decision makers. The Enterprise service has resulted in a surge of usage of letter mail, with our customers' letter mail postage spend increasing more than 50% year over year.

Most recently, we have focused on higher volume shippers, as this is one of the most important strategic initiatives of the Postal Service. Our technology includes: (1) batch capability that allows users to print a large volume of shipping labels all at once; (2) database integration technology for seamless automatic import and export of information to and from a customer's internal order database; and (3) direct integration with eCommerce platforms including eBay, PayPal, Amazon.com, Yahoo and Google, so that a user can read and write order information directly from our software into and out of these platforms. An e-commerce merchant with multiple stores can consolidate all their orders so they can ship them out with ease. With one click, they can directly import all of their order data from the most popular online marketplaces including eBay®, Amazon.com®, Yahoo!®, PayPal®, Google Checkout™ and Etsy, plus the most popular shopping cart software including ChannelAdvisor®, Magento®, osCommerce, ProStores™, Volusion®, X-Cart® and Zen Cart™. When they are ready to ship, they can just select the orders and print their shipping labels. All the shipping data including USPS Tracking will automatically post back to their web stores. They can also automatically order a carrier pickup, send an electronic manifest to the Postal Service, and generate a SCAN form, so all the carrier has to do is scan the form once and all of the packages are automatically in the Postal Service's computer systems. Stamps.com also has a deep integration partnership with Amazon's Merchant Marketplace. Merchants who sell in Amazon's Marketplace and ship the packages themselves can print postage for the packages via Stamps.com's integration as part of a seamless integrated process flow.

TODAY'S TOPIC

How innovation and modernization can allow the Postal Service to maintain and improve services, reduce costs, and increase revenues

We believe Public Private Partnerships are the best path forward for the Postal Service as technology innovation becomes increasingly important for its future. We think it would be a mistake to just dictate to the Postal Service that it should innovate new technology. Having the Postal Service create its own technology is not the most efficient approach. Instead, the Postal Service should encourage and enable the marketplace to develop, maintain and support modern technology. They should provide incentives for industry innovation that helps the Postal Service and its customers. This allows Postal Service customers to pick the best technology solutions for their needs. It is much more efficient. We would suggest as helpful a recent OIG White Paper called Public-Private Partnerships: Best Practices and Opportunities for the Postal Service, published June 24, 2013.

The single best opportunity for growth is in e-commerce shipping. Forrester Research projects online retail sales will grow at a compound annual rate of 10% from 2012-2017. By 2017, the web will account for 10% of U.S. retail sales. Because the Postal Service already visits every consumer address and has tremendous capacity to deliver more at low marginal costs, it is uniquely positioned to benefit.

The Postal Service's eCommerce shipping business has been on fire because of a deeply successful public private partnership set up over a decade ago. The existence of the PC Postage industry is based on a partnership between the Postal Service and private industry that was forged in 1995 when the Postal Service intelligently decided that the extremely challenging technology issues that needed to be solved to allow a standard PC to print U.S. legal tender (in the form of postage) in a secure and convenient method were best solved by private industry. Public Private Partnership in the PC Postage Industry takes the form of the Postal Service regulating industry participants to make sure they are secure and work well technically with the Postal Service's systems. The Postal Service also partners with the industry to achieve mutual win-win goals of improving the customer experience, increasing revenue, and minimizing costs. Pat Donahoe and so many of the dedicated Postal veterans who have ably worked with us for many years, deserve much credit for the success story that is the partnership between the Postal Service and the PC Postage industry. This structure led to industry participants such as Stamps.com inventing ideas and solving technical challenges that were considered unsolvable by most companies in the postage meter and postal service arenas at that point in time, and those ideas and our intellectual property are still the cornerstone of all postage printed online today. Furthermore, the PC Postage industry has spent hundreds of millions of dollars each on marketing, new product development, and ongoing maintenance and support. The Postal Service and its customer get the benefit of this spend.

The growth opportunity with PC Postage has the attractive benefit of providing jobs, both in industry and in the Postal Service. Every package produced is ultimately delivered by a city or rural letter carrier. Growth in PC postage means more packages to deliver, more letters to deliver, more volume to service. The volume is everywhere, but especially significant in rural areas where the Postal Service's marginal cost structure for delivering beats its competition. Public Private Partnerships also enable services for all segments of the marketplace. PC Postage brings world class technology support for those citizens who rely on the USPS every day, and for the fast growing e-Commerce community.

American Forest & Paper Association

American Forest & Paper Association
Donna Harman, President and CEO
Statement Submitted for the Record
Senate Committee on Homeland Security and Governmental Affairs
Hearing- "Outside the Box: Reforming and Renewing the Postal Service, Part I – Maintaining Services, Reducing Costs and Increasing Revenue Through Innovation and Modernization"
September 19, 2013

The American Forest & Paper Association (AF&PA) is pleased to submit this written statement to the Senate Homeland Security and Governmental Affairs Committee concerning the future viability of the United States Postal Service. We compliment Chairman Carper and Ranking Member Coburn for their bipartisan efforts to achieve comprehensive postal reform that addresses the financial crisis facing the Postal Service and we greatly appreciate the recent introduction of S. 1486, the Postal Reform Act of 2013. There are many constructive provisions in the proposed legislation which we believe will substantially contribute to the goal of stabilizing the Postal Service financially. However, there are several provisions in the bill as currently drafted that are counterproductive and will threaten the future reliance on mail as a competitive option for communication and commerce.

The American Forest & Paper Association (AF&PA) serves to advance a sustainable U.S. pulp, paper, packaging, and wood products manufacturing industry through fact-based public policy and marketplace advocacy. AF&PA member companies make products essential for everyday life from renewable and recyclable resources and are committed to continuous improvement through the industry's sustainability initiative - *Better Practices, Better Planet 2020*. The forest products industry accounts for approximately 4.5 percent of the total U.S. manufacturing GDP, manufactures approximately $200 billion in products annually, and employs nearly 900,000 men and women. The industry meets a payroll of approximately $50 billion annually and is among the top 10 manufacturing sector employers in 47 states.

The U.S. Postal Service (USPS) is the essential component of a $1.3 trillion mailing industry that employs nearly 8 million Americans in large and small business enterprises as diverse as advertising, printing, paper manufacturing, publishing, and financial services. Mail delivery is a valuable service upon which consumers in all 50 states rely. The paper industry has a vested stake in the success of the Postal Service, as approximately one-third, or $6 billion of consumer demand for paper-based communications and commerce is delivered through the mail system.

The Postal Service is facing unprecedented challenges to adapt to the evolving nature of how people communicate and conduct business. AF&PA recognizes that the highly mobile and internet-enabled economy has forever changed the dynamics of volume, mix, and cost to deliver mail. Although the Postal Service has significantly reduced its infrastructure and labor costs in response to declining mail volume, it is not enough. Financial instability and the constant threat of insolvency creates uncertainty for mailers and forces stopgap cost reduction measures that threaten to further accelerate mail volume decline. USPS cannot succeed without the help of Congress to pass comprehensive postal reform legislation that not only alleviates unreasonable financial burdens, but preserves and attracts customers.

Recommendations for legislation to restore long-term viability to the U.S. Postal Service

We support legislative measures that will help the Postal Service achieve long-term viability by realigning its outdated cost structure, encouraging new revenue sources, and leveraging its unique infrastructure to meet the service needs of future customers. AF&PA supports postal reform measures that take into account the following:

- Recognition that labor costs, benefits, and future obligations must be brought in-line with market competition. The handcuffs and unreasonable burdens of the current statutory requirements must be changed so that the USPS can have a chance to be competitive with private sector business. Reamortization of payments for prefunding retiree health benefits, and returning to USPS its overpayments to the Federal Employees Retirement System (FERS) should be part of the solution. In addition, USPS should be provided the flexibility to manage healthcare costs.

- Facility capacity must change with the evolving realities of communications and business transactions. The paper industry continues to address the fundamental problem of excess capacity head-on and so must the Postal Service. Over the past year USPS has demonstrated it is capable of reducing its mail processing network without major disruptions in service. Legislation should not prevent the Postal Service from continuing to right-size its infrastructure to achieve greater network efficiency and effectiveness.

- Retaining the Consumer Price Index (CPI) cap is essential to enable mail as a cost competitive option for business communications. Rate stability and predictability are requirements for business to stay with mail. Congress and USPS must recognize that raising prices while reducing service is not a successful strategy to address declining demand. An increase in postage has a direct and profoundly negative impact on postal volumes, resulting in a "death spiral" where additional price increases are needed to overcome volume that is driven out of the mailstream.

- The Postal Service Board of Governors should not be empowered with full authority over rates, subject only to an after-the-fact Postal Regulatory

Commission complaint process. The rate cap established under the Postal Accountability and Enhancement Act of 2006 (PAEA) wisely counterbalanced rate increases with required USPS cost controls. Elimination of the rate cap and giving essentially unchecked rate authority to the Board of Governors would resemble the onerous and expensive rate litigation process that PAEA eliminated.

- Potential service level reductions must realistically weigh cost savings against accelerated decline in volume. Regularity and reliability is the central value proposition of the Postal Service. We believe reducing delivery of mail to 5-days in order to cut costs will be counter- productive, disconnecting the Postal service from its customers and driving more mail out of the system. Given the magnitude of the USPS financial deficit, higher value cost savings options with less demand risk should be considered before reductions in service frequency.

We greatly appreciate the Chairman, the Ranking Member, and the Committee for making reform of the Postal Service a priority and look forward to working with both Chambers of Congress to enact comprehensive plans that will put USPS on a path to sustainability.

Prepared Statement of Jerry Cerasale
Senior Vice President, Government Affairs, Direct Marketing Association
Before the Subcommittee on Post Office and Civil Service
of the Committee on Governmental Affairs
March 14 and 18, 1996

Senator Stevens and Members of the Committee, I am Jerry Cerasale, Senior Vice President, Government Affairs, Direct Marketing Association, Inc. It is an honor to be invited to participate on the closing panel for this stage of your postal reform hearings.

You have already heard the testimony of DMA's President, Jonah Gitlitz, and I support his statement fully and will refrain from repeating his statements. It will be my pleasure to answer any questions you might have on the draft legislation that was presented by Mr. Gitlitz.

DMA commends the Committee for holding these hearings. This is a pivotal time for the United States Postal Service. The Information Age for which we have been waiting for at least a decade appears to be coming to fruition rapidly. How the Postal Service or any universal hard-copy delivery service responds to the information explosion is of great concern to the direct marketers in our nation. The United States Mail is an important link between direct marketers and their customers. At the moment, any disruption in the link would be fatal to many direct marketers.

Therefore, the consequences, both long term and short term, of any postal reform must be considered carefully.

The concern of all users of the Postal Service is that costs and, thus, rates are rising too quickly. Every mailer wants cost inflation to at least slow — absolute decline in costs would be wonderful. How to achieve that goal is where mailers — and the witnesses you have heard today and Thursday — differ. The postal reform legislation which is the goal of these hearings could take three basic forms: Minor changes, if any, to the Postal Reorganization Act; significant changes in the Act; or, elimination of the postal monopoly and creation of full and open competition.

Proponents of opening the Postal Service to immediate and total competition overlook the potential for disruption of the nation's hard-copy delivery network — especially the 180 billion pieces delivered by the Postal Service. The profit margin of most direct marketers is too low to sustain them through a significant disruption in the mailstream. The recent snows in January which crippled a large part of the Northeast disrupted mail service, and the bottom line for many DMA members suffered. The consequences would be much greater if the disruption were nationwide and over a sustained period of time.

Legislation with only minor changes, if any, would keep the status quo. DMA firmly believes that if the status quo remains, we will be watching the gradual demise of the Postal Service. Postal rates over the past 10 years have increased much faster than inflation; postal productivity despite a huge investment in equipment has not improved significantly; postal costs continue to rise; and new media is bringing new competition into communications. We do not want to stand by and watch our universal hard-copy network wither away. The Postal Service must be provided some incentive to control costs which will hold down rates and make the Postal Service more competitive. The status quo is not the answer.

The Postal Reorganization Act needs some significant adjustments to help the Postal Service face the future. Postmaster General Runyon, following in the footsteps of his predecessors, claims that the Postal Service needs more flexibility in pricing its products and to introduce new products. As Mr. Gitlitz testified, DMA agrees that it is time to give the Postal Service some of that flexibility. Of course, this new flexibility gives the Postal Service more freedom to fail as well as succeed. If Congress does enact legislation to granting the Postal Service more flexibility, oversight of the Postal Service becomes more critical.

Many users of First- and second-class mail oppose any greater pricing flexibility for the Postal Service. They are concerned that the Postal Service will favor other mailers to their detriment. DMA recognizes that fear. No monopoly should be given carte blanche authority to set its own rates. We believe there is a significant role for the Postal Rate Commission in any postal reform. The draft, legislation that was attached to Mr. Gitlitz' testimony provides for checks-and-balances while giving the Postal Service pricing flexibility.

First, the Postal Service may adjust rates without a Postal Rate Commission proceeding only if its costs are below inflation — not equal to. Second, the Postal Rate Commission — not the Postal Service — determines the index of postal costs through a public rulemaking procedure. Third, the Postal Rate Commission must certify that postal costs are below inflation. Fourth, any rate increase cannot exceed 75% of the rate of wage inflation. Fifth, there may be only one rate increase in a fiscal year. Sixth, all rates must be changed in the same proportion. The Postal Service may not favor one class of mail to the detriment of another. Finally, the authority to set rates without the Postal Rate Commission exists for only 5 years after the Postal Rate Commission has issued an omnibus fate decision.

Thus, pricing flexibility for the Postal Service would be tied to cost control. Without that control, the Postal Service will not have pricing flexibility. We believe that our approach to pricing flexibility protects and even strengthens Postal Rate Commission authority (along with subpoena power) and protects users of each class of mail from discriminate treatment by the Postal Service in the name of pricing flexibility.

The draft legislation also provides that the Postal Service without a proceeding before the Postal Rate Commission may implement experimental postal services which are limited in scope and duration. There are other provisions about which I would be pleased to answer questions but have already been discussed by Mr. Gitlitz.

Any postal reform must be balanced. But reform is needed. Without reform more and more companies will find the solutions to cost control that L.L.Bean faced and is facing — using alternative means to interact with its customers. The Postal Service and those mailers who have no alternative — many in rural America — will face higher and higher postage rates with no relief in sight.

Again, I thank you for the opportunity to appear before you today. It will be my pleasure to answer any questions you may have.

[Senate Hearing 110-340]
[From the U.S. Government Printing Office]

S. Hrg. 110-340

THE ROAD AHEAD: IMPLEMENTING POSTAL 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

FIRST SESSION

APRIL 19, 2007

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Excerpt:

OPENING STATEMENT OF SENATOR COBURN

Senator Coburn. Thank you, Mr. Chairman. I have a statement for the record I would like to have admitted. I won't spend the time and I will apologize to our guests that we have a Judiciary hearing of some importance going on now and I will be called to that momentarily.

I want to thank Senator Collins as well as Senator Carper and all those that worked on the postal reform bill. It is one of the few bills that I didn't try to stop last year and I want to be appreciated for that. [Laughter.]

I had no part in its delay. I want to talk about long term. We have hundreds of thousands of great employees that work for the Postal Service. This is an estimate of revenues and expenses. You all didn't prepare this, I prepared this, looking at what is happening and where it is going under the revised postal reform bill that was passed. What we see very soon is red. We saw red, $600 million. The real number was $600 million this past year. I believe that what has happened is a great intermediate step and I think we have to keep our eye on the ball.

People claim that I am an idealist. I am not. I am a realist that thinks in the long term, and so, therefore, that is reflected as being an idealist in the short term. But I think that the decisions that we ought to be talking about is what happens 10 years from now.

I appreciate very much the Chairman having this hearing, but I also think it is important that we continue. What is the next step? What has happened is the Postal Service has watched its costs grow faster than its revenues since 2003. It needs to be freed up to run more like a business and less like a bureaucracy if it is ever to dig out of what that chart is estimated on our behalf. I am not sure that everybody would agree with that, but I will show that again in 3 or 4 years and we will see how accurate it was.

The recently-passed reform legislation provided only for ways to increase postal rates without really creating ways to cut costs. Simply raising rates without cutting costs won't do anything in the long run to help the Postal Service because of who you compete with and how the world is changing. If Congress truly wants to reform the Postal Service, it will need to move beyond the traditional reforms that prop up monopolies and bureaucracy and move towards those that promote competition, markets, and innovation.

Senator Carper mentioned the technologic changes that have come about that have impacted First Class mail, and I had a wonderful conversation with the Postmaster General in my office, I believe it was this week or last week--last week, the weeks run together--and I am committed to seeing and believing that his management and those that work under him are great and are what we need, and so I would compliment you in that regard.

But my hope is that we are thinking 10 years down the road, because if we are and if we give you the tools, right now, three-quarters of your costs are labor costs, and yet on a large majority of those labor costs, you have no capability to control those. I don't begrudge the fact that the average postal employee in this country makes, with benefits, $20,000 more than the average person in this country. That is the facts. But if that is the case, and it is, then efficiency ought to be the No. 1 thing and performance ought to be the No. 1 thing and the power of management to get that efficiency that postal workers want to give ought to be there. The tools ought to be there.

So I look forward to your hearing. I have some questions that I would like to submit. My staff will stay here during the hearing. And again, I apologize to you for not being able to stay. I have reviewed the testimony and I thank each of our witnesses today.

[The prepared statement of Senator Coburn follows:]

OPENING STATEMENT OF SENATOR COBURN

My view of the U.S. Postal Service is akin to an iceberg floating in the Caribbean: even the best efforts can only help a little. This might seem harsh for an agency that recently had life breathed back into it through reform legislation passed late last year. But, if we are honest and face the facts, it is difficult to imagine a postal service in twenty years that looks anything like it does today.

For years, pressures inside and outside the Postal Service have mounted, pushing it dangerously close to the breaking point. Without the recently passed Postal Reform legislation the situation would be worse, for sure. But, it's is my opinion that the reforms we passed will do no more than simply keep the agency afloat a little longer than it otherwise would--I don't believe it can reverse the downward trend.

To roughly outline the problems, we have a situation in which revenues are growing at a rate of less than 2.5% per year while costs are growing around 5% per year. First-Class mail volume is plummeting, electronic communications are increasing, and labor costs are threatening to eat up any revenues that the postal service makes. It doesn't take much to realize that none of this adds up to a healthy bottom line.

The problems faced by the postal service, though, cannot simply be laid at the feet of management. Although every large organization can rise or fall on good management--which the postal service has had under Postmaster Potter--I want to emphasize that I believe the problem is primarily structural. By that, I mean that the postal service's problems cannot be solved with new management or by tinkering around the edges. The Postal Service must operate under conditions placed on it by Congress, and those conditions, if unchanged, will bring inevitable failure to thrive in the market and a financial millstone around the taxpayer neck.

There are three things I'm primarily talking about:

Structural Challenges Facing the Postal Service Competition

First, competition with private industry is a significant challenge and it does so with its ``competitive'' products--Express Mail, Priority Mail and Parcel Post. Most other products are protected by a Congressionally-mandated monopoly, though, which shields the Postal

Service from having to compete in everything it does. But, even limited competion has proven to be a huge challenge as we see in the fact that since 2002, revenues for Priority and Express Mail have been stagnant and volume has been down.

Competing with the private sector is good for the American public, and the fact that it is bad news for the Postal Service is a sign that the Postal Service is fundamentally structurally unsound. The only response to tough competition is to provide better services at better prices or continue to lose its share of the market. No reform legislation can completely address the challenge of competing with industry.

Labor Costs

Second, labor costs are another significant structural problem facing the Postal Service. Despite a decrease of 10,000 employees since 2004, the Postal Service's costs for compensation and benefits have increased by over $4 billion annually. Right now, labor costs account for over three-quarters of their annual operating budget. On the contrary, the Postal Service's competitors face far lower labor costs and are able to keep them under control.

Again, this is not necessarily the fault of the Postal Service, it's been imposed by a Congress that lacks the accountability that Fed-Ex or DHS owes to its shareholders. Powerful politicians and employee unions have combined forces to thwart any effort of the agency to control its labor costs. Until it is able to do so, labor will eat an ever-growing percentage of its budget and threaten to drag the agency into ruin.

Technological Advances

Even without the problems of competition and labor costs, the business model of the Postal Service would be fatally flawed. That's because the most significant problem facing the Postal Service is that it is losing relevance in the face of technology advances. The Internet, telephone and fax have displaced much of what was previously sent by mail. Instead of sending bills or taxes by mail, more and more Americans are going online. In fact, according to the IRS more than 73 million Americans filed taxes online last year.

These advances are revolutionizing the world of communication in business, entertainment and social relationships. This is a great thing--consumers are getting high-speed, well-documented, convenient services and these have revolutionized our world. We should be applauding these changes. It is the American people who are our ``clients'' not the Postal Service--and we must first and foremost think of what they want, need and expect--what's good for them, not what's good for the government.

Where Do We Go From Here?

The three factors I've laid out--competition, labor and technology--were not challenges created by the Postal Service, but they are real, and they must be faced.

Facing these challenges will require the Congress to go beyond the typical ``reform" legislation that addresses how rates are changed, escrow accounts are tallied or members are appointed to boards. Rather, we will need to reconsider the very fundamental questions such as:

Is it essential that mail delivery remain a core government function?

Is it time to rethink the definition of ``universal service"?

Whose needs are being served by the current system? The American public or others?

These, I believe, are the questions that need to be asked and the questions I hope to answer in this hearing in the months to come.

Senator Carper. Let me yield now to Senator Akaka for any statement he might have.

Excerpt from:

S. Hrg. 105-690

S. 2082—THE INTERNATIONAL POSTAL SERVICES ACT OF 1998

HEARING

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL SECURITY, PROLIFERATION, AND FEDERAL SERVICES

OF THE

COMMITTEE ON GOVERNMENTAL AFFAIRS UNITED STATES SENATE

ONE HUNDRED FIFTH CONGRESS

SECOND SESSION

ON

S. 2082

TO AMEND CHAPTER 36 OF TITLE 39, UNITED STATES CODE, TO PROVIDE AUTHORITY TO FIX RATES AND FEES FOR DOMESTIC AND INTERNATIONAL POSTAL SERVICES, AND FOR OTHER PURPOSES

JUNE 2, 1998

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e. Congress Should Require a Study of Unequal Application of Other Laws

In addition to mandating immediate changes in the application of the foregoing laws, DHL believes that international postal reform legislation should also provide for a study by Department of Justice of other legal disparities in the treatment of competitive international services provided by the USPS and private firms. A detailed, objective study of all differences in treatment is crucial to assuring that the goal of equal treatment for competitive international services is, in fact, fully implemented. Congress should move rapidly to fully implement any recommended changes as soon as possible after the issuance of the Department's report.

V. Conclusion

In areas such as trade and telecommunications, the United States has been a world leader in efforts to free international markets from outdated regulatory schemes which hamper free and fair competition. Some foreign countries are beginning to liberalize their own postal regimes by moving toward privatization. Liberalization is long overdue in our own Nation's postal laws as well. DHL believes that enactment of S. 2082, together with the additional provisions described above, is an important first step in this process. DHL is pleased to support S. 2082 and looks forward to working with the Chairman and Members of this Subcommittee on this important legislation.

PREPARED STATEMENT OF DIRECT MARKETING ASSOCIATION

Chairman Cochran and Members of the Subcommittee on International Security, Proliferation and Federal Services:

Thank you for this opportunity to testify on S. 2082, a bill that would place the setting of international postal rates under the authority of the Postal Rate Commission in the same manner that domestic postal rates are established.

Established in 1917, The Direct Marketing Association is the oldest and largest trade association for business and nonprofit organizations using direct marketing to reach their customers, members, and prospects. We represent more than 3,600 companies in the United States and 47 other nations. These include members such as L.L. Bean, which will have an official testifying at this hearing, that are becoming increasingly involved in the global marketplace.

In addition, this statement is being made on behalf of the Coalition in Support of International Trade and Cooperation, a group of postal customers, trade associations representing those customers, and postal employee organizations and unions, all of which will be significantly affected by this legislation. The members of the coalition include:

Advertising Mail Marketing Association, Washington, D.C.
American Postal Workers Union, Washington, D.C.
Ballard Designs, Atlanta, GA
L.L. Bean, Freeport, ME
Current, Inc., Colorado Springs, CO
Damark International, Inc., Minneapolis, MN
The Direct Marketing Association, Washington, DC
Fingerhut Companies, Inc., Minnetonka, MN
Frontgate, Lebanon, OH
Garnet Hill, Lebanon, NH
Hammacher Schlemmer, Chicago, IL
J.C. Penney Company, Plano, TX
Land's End, Dodgeville, WI
Mail Order Association of America, Washington, D.C.
National Association of Letter Carriers, Washington, D.C.
National Association of Postal Supervisors, Alexandria, VA
National Association of Postmasters of the United States Alexandria, VA
National League of Postmasters, Alexandria, VA
National Retail Federation, Washington, DC
National Rural Letter Carriers Association, Arlington, VA
Parcel Shippers Association, Washington, DC
Performance Data TransUnion Corporation, Chicago, IL
Territory Ahead, Santa Barbara, CA
TravelSmith, Novato, CA
Whispering Pines, Fairfield, CT

We respectfully oppose S. 2082 in its current form.

S. 2082 would place international postal rates under the ratemaking process outlined in Title 39 of the U.S. Code. That process was the creature of the Postal Reorganization Act of 1970, which removed postal rate making from the legislative process to a regulatory process superficially similar to public utility ratemaking.

In that process, the Postal Service Board of Governors is solely responsible for developing and proposing increases in the rates of postage. When it decides rate adjustments are necessary, the board files an extensive request with the Postal Rate Commission, which then commences an extensive proceeding on the record in accordance with the Administrative Procedure Act.

The Postal Rate Commission must complete its consideration of the proposal within ten months. If it has not issued a recommended decision within that time frame, the Governors may put their proposed rates into effect on a temporary basis . However, this has not happened in a major rate case since the ten month period was enacted in the late 1970's.

When it concludes its proceeding, the Commission then forwards its recommended decision to the Governors, who have sole authority to implement the new rates. If the Governors disagree with the Commission's recommendations, they have a series of options including refusing to implement the rates or sending the recommended rates back to the Commission for reconsideration. After the commission sends the reconsidered case back to the Governors, the Governors may then change the proposed rates by a unanimous vote. This has happened once in a major rate case, in 1980.

We feel that this process is much too cumbersome, time consuming, and expensive for domestic rates and see nothing but harm to customers of both the Postal Service and its competitors in applying this process to international rates

We are opposed to S. 2082 for four basic reasons:

1. It would place the Postal Service in a severely negative competitive position by removing the flexibility to set international rates when necessary to meet competitive pressures and provide the best service for its customers. The complexity and length of the ratemaking process mandated by this bill would probably mean that the Postal Service could not compete against its largely unregulated competitors.

The bill is being pushed by competitors of the Postal Service as "leveling the playing field." Just the opposite would occur. No competitor of the Postal Service in the international mail field is required to submit to a lengthy rate proceeding. They are essentially free to set prices as they wish, when they wish.

The requirement for a lengthy rate proceeding would be anti-competitive for another reason. Competitors would get an advance glimpse at new products, which would give them ample opportunity to develop counter measures to meet and beat the new competition. Businesses in other fields , say the automobile industry, would dearly love to have this competitive advantage over their rivals.

In the final analysis, the principal losers in this battle of the behemoths—the Postal Service and its competitors—will be American businesses that are working to build their international business.

2. The Postal Rate Commission already has on file data that, in our opinion, show that the Postal Service is not using money from other classes of mail to subsidize international postal rates. Overall, international postal rates cover all of their attributable costs and contribute more than $300 million annually to overhead costs.

The concern about cross-subsidization is a legitimate one, and one that was addressed directly in the Postal Reorganization Act of 1970, which forbids cross-subsidization. A simple reporting requirement, however, would be sufficient and far less destructive to the international business of the Postal Service and its customers.

3. The process of setting international postal rates is ultimately based on treaties and agreements among nations in accordance with policies developed by the Universal Postal Union, all of which are and should be outside the purview and cost-based regulatory expertise of the Postal Rate Commission.

In fact, the extensive hearings before the Commission required by S. 2082 would require the Postal Service to provide specific country-by-country data which could undermine America's position in any treaty negotiations on international postal rates with other countries. This bill would further unlevel the playing field against the Postal Service in favor of foreign nations whose postal authorities, such as Royal Mail and Dutch Post, are already operating in the United States and competing with the Postal Service and American businesses for international mail business. This bill creates a tilted playing field that favors foreign countries over the American government, American businesses and American workers.

4. The failure to include international postal rates in the ratemaking process created by the Postal Reorganization Act was not an "oversight." Prior to the Postal Reorganization Act, Congress, through the regular legislative process, set all domestic postal rates, but never set international rates. Those rates were always set by the Postal Service by the process mentioned above. Congress saw no need to change that process.

Much has been made by postal competitors about "leveling the playing field" in the competition for international mail and parcels. The charges are that the Postal Service enjoys advantages that private companies do not have that tilt the playing field toward the Postal Service. They claim that this is particularly true in the international area.

The truth, we believe, is far more complex than that. Both the Postal Service and private competitors enjoy unique advantages and suffer from unique disadvantages that affect their ability to compete and affect the service that we customers receive. We agree that a full study should be made to determine what needs to be done, if anything, to assure that the playing field is indeed level in the international area.

One thing is certain now, however, is that S. 2082 would dangerously tilt the playing field against the Postal Service in its efforts to compete effectively in the volatile international mail market. Customers, American businesses, can only lose.

LETTER FROM R.R. DONNELLEY AND SONS COMPANY FOR THE RECORD

R.R. DONNELLEY AND SONS COMPANY
June 2, 1998

Hon. Thad Cochran, *Chairman*
Subcommittee on International Security, Proliferation and Federal Services
Committee on Governmental Affairs
U.S. Senate
Washington, DC

DEAR MR. CHAIRMAN: I am pleased to offer the views of R.R. Donnelley and Sons Company for the record of the Subcommittee's June 2, 1998 hearing on S. 2082, the International Postal Service Act of 1998. As both the leader of the U.S. printing industry and the largest customer of the U.S. Postal Service (USPS), our company has a significant stake in assuring the continued global competitiveness of both the postal system and mailed print. We greatly appreciate your leadership on the entire array of postal issues and urge the Subcommittee to carefully consider the implications of this legislation, which has the potential for unintended, yet adverse, consequences.

Introduction

As you know, R.R. Donnelley and Sons Company is a $5+ billion, Fortune 250 leader in the management, reproduction, and distribution of print and digital information for the publishing, retailing, merchandising and information technology industries. We employ over 25,000 people throughout the world, with plants and facilities in 31 States, including such States as Mississippi, Pennsylvania and Illinois.

Simply put, it is reasonably-priced, universal service on both an international and domestic basis that drives our business interest in postal policy issues such as S. 2082. We share and support our customers' need for a global distribution channel that provides universal service to residential and commercial customers every day in a predictable and consistent manner. to this end, we engage the services of the U.S. Postal Service—as well as those of United Parcel Service, Federal Express and a variety of other alternative service providers—in serving the global business needs of our customers. We foresee no change to this requirement and, therefore, are concerned about any potential changes to current law that would hamper the ability of our customers to access any of the existing international mail options currently available to them.

That having been said, we also state our appreciation and endorsement of the basic principle underlying S. 2082. It does not serve either our customers' interests or our own to have the Postal Service subsidize its international postal services through revenues derived from its domestic services. At the same time, we believe with equal conviction that neither the American economy nor the American public is well served by subjecting the U.S. Postal Service to an additional layer of regulation in the international arena unless and until all alternatives have been very thoroughly explored and found inadequate to the task.

Key Policy Issues

As we stated in our comments to House Postal Subcommittee Chairman John McHugh on the proposed revisions to H.R. 22, we believe there is an important need to update the existing statutory framework which governs the operations of the USPS. The current statutory blueprint was enacted nearly three decades ago: Prior to the first global oil embargo, prior to the reengineering that has so dramatically changed the operations of so many companies in both the manufacturing and service

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BEFORE
THE POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Notice of Market-Dominant Price Adjustment) Docket No. R2013-1

Comments of the Direct Marketing Association
Responding to Commission Order No. 1556

The Direct Marketing Association (DMA) appreciates the opportunity to comment on the Postal Service's response to Commission Order No. 1541 further adjusting the postal rates for Standard Mail Flats. DMA represents approximately 2,000 member companies that use data to market directly to consumers and businesses or that support those marketers. Our members use all channels of communication including the U.S. Mail.

Although DMA is not overjoyed with the further adjustment upward of any postage, we support the Service's further adjustment. One of the rationales for the current ratemaking provisions in the law was to avoid rate shock and to provide mailers a clear understanding of what to expect for future postage changes. We applaud the Service for its rapid response to Order No. 1541 in order to eliminate any confusion for mailers that resulted from Order No. 1541. DMA urges the Commission to approve those adjustments. Further delay will add more confusion for mailers which is not productive for them or the Postal Service.

The Commission should not take DMA's support of the Postal Service's further adjustments as support for Order No. 1541. DMA agrees with Commissioner Taub that the Service did have a plan to reduce costs which, as the Postmaster General has stated, would bring all underwater products above water. That is what the Commission desires, and we believe the Service provided that information in its original announcement.

DMA believes that the Commission does not have authority to require this further adjustment in this proceeding. 39 USC Section 3622(d)(1)(C)(iii) limits the Commission in this proceeding to:

> ...notify the Postal Service of any noncompliance of the adjustment with the limitation under subparagraph (A);....

Subparagraph (A) concerns the CPI cap limitation on market-dominant postal rates. It does not concern the cost coverage of any postal product. The Commission may order adjustments of postal rates in its Annual Determination of Compliance pursuant to 39 USC section 3653 (c). In other words, this was the wrong proceeding for the action the Commission required in Order No.

1541. The uncertainty that Order No. 1541 raised within the mailing community is exactly what Congress sought to avoid by limiting the Commission's rate review under section section 3622.

In conclusion, DMA supports the adjustment and opposes the reasoning requiring it.

Respectfully submitted,

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ORDER NO. 1541

UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Before Commissioners:

Ruth Y. Goldway, Chairman;
Nanci E. Langley, Vice Chairman;
Mark Acton;
Tony Hammond; and
Robert G. Taub

Notice of Market-Dominant
Price Adjustment

Docket No. R2013-1

ORDER ON PRICE ADJUSTMENTS FOR MARKET DOMINANT PRODUCTS
AND RELATED MAIL CLASSIFICATION CHANGES

Washington, DC 20268-0001

November 16, 2012

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Dissent in Part of Commissioner Taub

APPENDIX A—List of Commenters

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UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Before Commissioners: Ruth Y. Goldway, Chairman;
Nanci E. Langley, Vice Chairman;
Mark Acton;
Tony Hammond; and
Robert G. Taub

Notice of Market-Dominant Price Adjustment — Docket No. R2013-1

ORDER ON PRICE ADJUSTMENTS
FOR MARKET DOMINANT PRODUCTS
AND RELATED MAIL CLASSIFICATION CHANGES

(Issued November 16, 2012)

I. INTRODUCTION AND OVERVIEW

On October 11, 2012, the Postal Service filed notice of its planned price adjustments for most market dominant products.[1] The Postal Service also proposes to implement numerous mail classification changes in conjunction with the price adjustments. Most of the classification changes affect Special Services.

The Commission has reviewed the pricing proposals for consistency with the requirements of title 39. Pursuant to 39 CFR 3010.13(j), the Commission finds provisionally that the planned price adjustments do not violate the price cap in 39 U.S.C.

[1] The citation to the Postal Service's notice appears in section II. Procedural History.

3622(d); are consistent with, or justified by an exception to, the workshare discount limitations in 39 U.S.C. 3622(e); and establish prices that satisfy 39 U.S.C. 3626.

The Commission also has reviewed the pricing proposals for compliance with applicable Commission directives and orders. The Commission finds that the Postal Service proposed Standard Mail Flats rates fail to satisfy the applicable directives set forth in the FY 2010 Annual Compliance Determination (ACD), and further clarified and reaffirmed in Order No. 1427, and Order No. 1472.[2]

In recognition of the Postal Service's authority to develop rates to meet applicable legal requirements, the Commission remands all Standard Mail rates to allow the Postal Service to modify its planned rates to comply with the FY 2010 ACD and applicable statutory standards. The Postal Service could comply with these directives by adjusting a limited number of Standard Mail Flats prices.

Pursuant to 39 CFR 3010.13(e), the Postal Service shall file its amended notice of rate adjustment and describe how the modifications to the planned Standard Mail Flats rate adjustments comply with applicable legal requirements. An opportunity for comments from interested parties will be provided. *See* 39 CFR 3010.13(f). The amended notice is due within 10 days of this Order so that new rates that comply with applicable legal requirements can be reviewed and implemented, as planned, on January 27, 2013.

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[2] Docket No. ACR2010, Order No. 1427, Order on Remand, August 9, 2012; Docket No. ACR2010-R, Order No. 1472, Notice and Order Confirming Termination of Stay, September 21, 2012.

II. PROCEDURAL HISTORY

Background. On October 11, 2012, the Postal Service filed a Notice of Market-Dominant Price Adjustment with the Commission in conformance with 39 U.S.C. 3622(d)(1)(C) and Commission rules in 39 CFR Part 3010.[3] The Notice announces the Postal Service's intention to change most domestic and international market dominant prices on January 27, 2013 at 12:01 a.m. by amounts which are, on average, within a 2.570 percent statutory price cap for all classes of mail.

The Notice includes three attachments presenting detailed price and mail classification changes; worksharing discount calculations; and price index change calculations. Supporting workpapers address, for each class, how the planned prices comply with the price cap. First-Class Mail International data and information appear in both public and non-public workpapers, pursuant to the Postal Service's interest in non-public treatment for certain material.[4] The Postal Service Application was not opposed.

Commission Order No. 1501, issued October 15, 2012, provided public notice of the Postal Service's filing; established Docket No. R2013-1 to consider the planned price adjustments; and appointed a Public Representative.[5] Pursuant to rule 3010.13(a)(5), the Commission allowed 20 days for public comment. By Order No. 1522, the Commission granted a 1-day extension (from October 31, 2012 to

[3] United States Postal Service Notice of Market-Dominant Price Adjustment, October 11, 2012 (Notice). *See* Appendix A for citations to subsequent errata notices. In companion Docket No. CP2013-3, the Postal Service proposed price adjustments for competitive products to take effect January 27, 2013, in conjunction with planned market dominant price adjustments. The Commission addressed the competitive price adjustments in Order No. 1526, issued November 8, 2012.

[4] Notice of the United States Postal Service of Filing of USPS-LR-R2013-1/NP1, October 11, 2012, including Attachment 1, Application of the United States Postal Service for Non-public Treatment of Materials (Postal Service Application).

[5] *See* Notice and Order on Planned Rate Adjustments and Classification Changes for Market Dominant Postal Products, October 15, 2012 (Order No. 1501), appearing at 77 FR 64362 (October 19, 2012).

November 1, 2012) due to storm-related power outages and the closing of federal agencies, including the Commission, pursuant to a United States Office of Personnel Management directive.

Supplemental data and information. The Commission issued, and the Postal Service responded to, one multi-part information request seeking clarification of the Postal Service's planned price adjustments for Standard Mail Flats and Standard Mail Letters.[6] Seven Chairman Information Requests were issued seeking clarification or further explanation of additional Standard Mail pricing matters and other aspects of the Postal Service's filing. Appendix B provides citations to these information requests, to Postal Service's responses, and to related filings.

Commenters. The Commission received 12 sets of formal comments in response to Order No. 1501, including two sets filed on behalf of multiple commenters and two sets filed by one commenter. Appendix C provides a list of commenters and citations to their filings. The Postal Service filed Reply Comments.[7] Valpak filed an objection to acceptance of the Postal Service Reply Comments.[8]

Motion practice. On October 22, 2012, Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. filed a motion to strike the portion of the Notice addressing planned price increases for Standard Mail.[9] On October 31, 2012, the

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[6] *See* Commission Information Request No. 1, October 18, 2012 (CIR No. 1) and Responses of the United States Postal Service to Questions 1-6 of Commission Information Request No. 1, October 23, 2012.

[7] *See* Reply Comments of the United States Postal Service, November 9, 2012 (Postal Service Reply Comments) and Motion of the United States Postal Service for Leave to File Reply Comments, November 13, 2012 (Postal Service Motion for Leave to File Reply Comments). Reply Comments were not specifically authorized in this case. The Commission grants the Postal Service Motion for Leave to File Reply Comments.

[8] Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Objection to United States Postal Service Reply Comments, November 13, 2012.

[9] Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Motion to Strike Standard Mail Price Adjustment from United States Postal Service Notice of Market-Dominant Price Adjustment, October 22, 2012 (Valpak Motion to Strike).

Postal Service and L.L. Bean, Inc. filed responses opposing the Valpak Motion to Strike.[10] The issues raised in the Valpak Motion to Strike were also addressed in several of the participant comments provided in response to Order No. 1501. These issues are fully addressed in section IV. B. of this Order.

[10] Response of the United States Postal Service in Opposition to Valpak's Motion to Strike Standard Mail Price Adjustment from Notice of Market-Dominant Price Adjustment; Response of L.L. Bean, Inc. to Valpak Motion to Strike Standard Mail Price Adjustment, both dated October 31, 2012.

III. FIRST-CLASS MAIL

A. Introduction

There are six products assigned to First-Class Mail: Single-Piece Letters/Postcards, Presorted Letters/Postcards, Flats, Parcels, Outbound Single-Piece First-Class Mail International, and Inbound Single-Piece First-Class Mail International. The Postal Service proposes to increase the price for First-Class Mail, on average, by 2.570 percent. Notice at 6. The Postal Service does not use any of its -0.530 percent banked pricing authority. *Id.* After applying the 39 CFR 3010.26(c) adjustment, the Postal Service calculates a new unused pricing authority of -0.530 percent. *Id.*

The Postal Service reports the percentage price changes for individual products within First-Class Mail as follows:

Table III-1

First-Class Mail Product Price Changes

First-Class Mail Product	Price Changes (%)
Single-Piece Letters/Postcards	2.283
Presorted Letters/Postcards	2.555
Flats	2.675
Parcels	4.971
Outbound Single-Piece First-Class Mail International and Inbound Single-Piece First-Class Mail International (combined)	7.923
Source: United States Postal Service Notice of Errata to USPS-LR-R2013-1/1, CAPCALC-FCM-R2013.xls, worksheet "Percent Change Summary".	

In this price adjustment, the Postal Service increases the price of the first ounce, single-piece First-Class Mail letter by one cent to 46 cents. *Id.* at 19. The Postal Service retains the single-piece additional ounce price of 20 cents. The price of a single-piece postcard is increased from 32 cents to 33 cents. *Id.* at 15. The price of the first ounce for a single-piece flat is increased from 90 cents to 92 cents. *Id.*

The Postal Service introduces a new classification for single-piece residual letters weighing up to 2 ounces.[11] The Postal Service proposes a 48 cent price applicable to all residual pieces. Residual letters weighing more than 2 ounces will pay the single-piece First-Class Mail letter price of 46 cents plus the additional ounce price of 20 cents for each additional ounce.

First-Class Mail Parcels receives a 4.971 percent increase. *Id.* at 17. Only Retail Parcels and Keys and Identification Device price categories remain within the Parcels product as market dominant.

Most other First-Class Mail prices are adjusted accordingly to achieve the average 2.570 percent price change.

The commenters addressing First-Class Mail compliance with the price cap, Greeting Card Association (GCA), Pitney Bowes, and the Public Representative, state that the Postal Service has complied with the First-Class Mail price cap requirements of 39 U.S.C. 3622(d)(1).[12] The other commenters addressing First-Class Mail, National Association of Presort Mailers (NAPM), National Postal Policy Council (NPPC), Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. (Valpak), and the joint comments of Direct Marketing Association, Inc. (DMA), the Mailing and Fulfillment Service Association (MFSA), NPPC, and the Parcel Shippers Association (PSA), offer

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[11] *Id.* at 15-16. Residual letters are mailpieces prepared as part of a First-Class Mail Presorted Letters/Postcards mailing that remain after completion of a presort sequence and do not qualify for First-Class Presorted Letter/Postcards prices.

[12] Comments of the Greeting Card Association, October 31, 2012, at 1 (GCA Comments); Comment of Pitney Bowes Inc., November 1, 2012 (Pitney Bowes Comments); Public Representative Comments in Response to United States Postal Service Notice of Market Dominant Price Adjustments, November 1, 2012, at 8 (PR Comments).

no opinion on the Postal Service's compliance with the price cap.[13]

Commission analysis. The percentage price changes developed by the Commission are slightly different than those developed by the Postal Service. The Postal Service's price changes by product did not incorporate the effect of the proposed First-Class Mail promotions in the calculation of the price change for the class. When calculating the price change for the class, the Postal Service accounted for the promotions by applying a separate adjustment. The Commission also uses accepted methodologies when developing percentage price changes for International First-Class Mail.

The Commission includes the forgone revenue from promotions in the calculation of price changes by product. The Commission allocates forgone revenue from the Mail to Mobile Promotions to Presorted Letters/Postcards and Flats. The revenue forgone from the Earned Value Reply Mail Promotion is allocated to Presorted Letters/Postcards.[14] The resulting price changes for Presorted Letters/Postcards and Flats are 2.467 percent, and 2.674 percent, respectively. *See* PRC-LR-R2013-1/2.

The Commission finds the Postal Service's planned price adjustments for First-Class Mail comply with the price cap limitations specified by 39 U.S.C. 3622(d). The Commission finds that the planned prices for individual components of First-Class Mail result in an increase in the price for First-Class Mail, as a class, of 2.568 percent.

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[13] Comments of the National Association of Presort Mailers, November 2, 2012 (NAPM Comments); Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Comments on the United States Postal Service Notice of Market-Dominant Price Adjustment, November 1, 2012 (Valpak Comments); Joint Comments of the Direct Marketing Association, Inc., the Mailing and Fulfillment Service Association, the National Postal Policy Council, and the Parcel Shippers Association, November 2, 2012 (Joint Comments).

[14] In response to CHIR No. 4, question 6, the Postal Service allocates revenue foregone from the Earned Value Reply Mail Promotion to Presort Letters and Cards. Because the rebate results from the sending of Business Reply Mail and Courtesy Reply Mail, an argument can be made that allocating the revenue forgone to Single-Piece Letters/Postcards is more accurate. The proper allocation of revenue forgone from promotions that involve more than one product may be explored further and refined in a separate docket.

This creates 0.002 percent new unused rate authority. The sum of all unused rate adjustment authority for First-Class Mail, from the instant price adjustment and previous price adjustments, is -0.528 percent.[15]

B. First-Class Mail Worksharing

The First-Class Mail worksharing discussion is separated into three areas: Qualified Business Reply Mail (QBRM) discounts, automation letters and cards worksharing, and automation flats worksharing. Comments on appropriate price signals are also discussed. The Commission has reviewed the workshare discounts submitted by the Postal Service and concludes that the proposed price adjustments are consistent with the worksharing requirements of title 39.

Qualified Business Reply Mail (QBRM) Discounts. The Postal Service reduces the QBRM discounts for letters and cards from 2.2 cents to 1.7 cents. Given the Postal Service's estimates of avoided costs of 0.9 cents per piece for letters and cards, the passthrough of avoided costs is 212.5 percent. Notice at 37. The Postal Service contends that reducing the QBRM discounts further (raising the QBRM prices) is not desirable from a business perspective. Referencing the exceptions for discounts exceeding 100 percent in 39 U.S.C. 3622(e)(2)(A), the Postal Service argues that reducing the discounts may undercut the objective of the Earned Value Reply Mail Promotion for returned Business Reply Mail (BRM) and Courtesy Reply Mail (CRM) pieces. *Id.* at 38.

In Docket No. R2012-3, the Commission noted that the models used by the Postal Service may not accurately determine QBRM cost avoidances. It urged the Postal Service to develop a proposal to improve the methodology for determining QBRM cost avoidances.[16] In Docket No. RM2012-2, the Postal Service proposed, and

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[15] *See* PRC-LR-R2013-1/2, Compliance Calculations for First-Class Mail.

[16] Docket No. R2012-3, Order No. 987, Order on Price Adjustments for Market Dominant Products and Related Mail Classification Changes, November 22, 2011, at 14.

the Commission approved with some modifications, a new methodology for calculating the QBRM cost avoidance estimates.[17] Based on the cost avoidance estimates resulting from the application of the new methodology, the discounts for QBRM letters and cards pass through 100 percent of the costs avoided.

Automation letters and cards worksharing. The Postal Service calculates the following passthroughs of avoided costs for automation letters: Mixed automated area distribution center (AADC), 93.2 percent; AADC, 100.0 percent; 3-Digit, 0.0 percent; and 5-Digit, 96.0 percent. The Postal Service calculates the following passthroughs of avoided costs for Automation Cards: Mixed AADC, 121.1 percent; AADC, 109.1 percent; 3-Digit, 0.0 percent; and 5-Digit, 100.0 percent.[18]

The Postal Service cites the large decrease in the avoided cost between FY 2010 and FY 2011 as the reason for the excessive passthrough for Mixed AADC cards. Notice at 39. The Postal Service's proposal reduces the discount from 2.5 cents to 2.3 cents to bring the passthrough closer to 100 percent. The Postal Service argues that setting the Mixed AADC cards passthrough at 100 percent would not only increase the price of Mixed AADC automation cards higher than what is proposed, but would lead to higher increases for all the other presort levels. *Id.* It contends that this should be mitigated to avoid rate shock (39 U.S.C. 3622(e)(2)(B)). *Id.*

The Postal Service asserts that for AADC cards, the passthrough exceeds 100 percent, pursuant to section 3622(e)(2)(D). *Id.* at 40. In Docket No. R2012-3, the Postal Service set the prices for AADC and 3-Digit automation letters equal as a way to manage operational and network realignment issues. In the instant docket, the Postal Service proposes to make the same change to AADC and 3-Digit automation cards so

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[17] Docket No. RM2012-2, Order No. 1383, Order Concerning Analytical Principles for Periodic Reporting (Proposals Sixteen through Twenty), June 26, 2012.

[18] *See* PRC-LR-R2013-1/1, Compliance Calculations for First-Class Mail.

mailers can more easily combine 3-Digit and AADC cards and letters and calculate the postage accurately.[19]

Automation flats worksharing. The Postal Service calculates the following passthroughs of avoided costs for automation flats: ADC, 178.6 percent; 3-Digit, 100.0 percent; and 5-Digit, 100.0 percent. The Postal Service cites FY 2008 methodology changes, as explained in Docket No. RM2008-2, Proposal Eight, as the major reason the ADC flats passthrough exceeds 100 percent. The Postal Service argues that setting all flats worksharing passthroughs at 100 percent would lead to significantly higher prices. It contends that this should be mitigated to avoid rate shock (39 U.S.C. 3622(e)(2)(B)). Notice at 41.

Pitney Bowes observes that the Postal Service has overstated the First-Class Mail ADC automation flats passthrough as 178.6 percent by using out-of-date cost avoidance figures. Pitney Bowes Comments at 6. It notes that a subsequently revised cost model approved by the Commission (Docket No. RM2012-2), and further additional changes proposed by the Postal Service (Docket No. RM2012-8) result in a passthrough of 92.6 percent. Pitney Bowes suggests revisions to the Commission's rules to require that cost avoidance estimates be derived using the most recent Commission approved methodology. *Id.* at 7.

The Commission concurs with Pitney Bowes that the Commission's rules may need to be revised to ensure that the most up to date methodologies are incorporated in price adjustment filings, and the Commission intends to explore this matter.

Pricing Signal comments. Several commenters express concern that the Postal Service is pricing in a way that encourages less finely sorted mail in order to use excess capacity. NAPM, NPPC, and Pitney Bowes note that presort First-Class Mail letters are more profitable to the Postal Service than single-piece First-Class Mail letters. NAPM

[19] NPPC contends that the price difference between AADC and 3-Digit for First-Class Mail postcards should not be eliminated. NPPC Comments at 11.

Comments at 2; NPPC Comments at 1, 3; Pitney Bowes Comments at 2. NAPM also observes that the volume of presorted mail is declining at a slower pace than single-piece mail. Given the value of presorted mail, NAPM, NPPC, and Pitney Bowes contend that the Postal Service is sending the wrong pricing signals by giving a greater percentage increase to presort First-Class Mail than to single-piece First-Class Mail, and by not passing through 100 percent of avoided costs for several worksharing discounts. NAPM Comments at 4; NPPC Comments at 5-6; Pitney Bowes Comments at 3. They argue that this is indicative of a disturbing trend in pricing strategy to drive mail volumes towards operations with excess capacity. NAPM Comments at 5; NPPC Comments at 6-7; Pitney Bowes Comments at 4-5. The joint comments of DMA, MFSA, NPPC, and PSA express agreement with the views presented above. *See* Joint Comments.

NPPC also comments that adoption of a single-piece metered mail worksharing benchmark would be more reasonable in setting presort discounts. NPPC Comments at 10.

Persuasive evidence has not been presented on the record to determine if the Postal Service's pricing strategy for First-Class Mail is focused on utilizing excess capacity. The Commission concludes that the proposed price adjustments are consistent with the worksharing requirements of title 39.

C. Classification Changes

The Postal Service proposes three notable classification changes for First-Class Mail products. It introduces a new price for single-piece residual letters, an International Forever Stamp, and a handling surcharge applied to foreign-origin, inbound direct entry mail tendered by foreign postal operators.

Single-piece residual letters. The Postal Service introduces a new classification for single-piece residual letters weighing up to 2 ounces. Notice at 15-16. The price is

48 cents. Currently, presort letters (non-automation and automation) pay the same price up to 2 ounces. Letters that do not meet presort requirements require mailers to separate their residual letters into groups of 1 and 2 ounces in order to accurately calculate postage at the single-piece First-Class Mail price for each ounce. By establishing a single price for residual letters up to 2 ounces, mail preparation requirements are simplified. Mailers will be able to prepare and present their residual letter mailings to the Postal Service with 1 and 2 ounce letters combined.

Pitney Bowes supports the new price and classification for single-piece residual letters. Pitney Bowes Comments at 6. However, Pitney Bowes contends that further refinements are necessary for residual pieces weighing more than 2 ounces. It urges the Postal Service to work with the mailing community to develop a solution applicable to all mail weighing more than 1 ounce. *Id.* NPPC notes that the new classification is well intended, but that a rate design resulting in a price of 46 cents would have been more appropriate. NPPC Comments at 17.

International Forever Stamp. The Postal Service introduces an International Forever Stamp for outbound single-piece First-Class Mail International letters. The proposed International Forever stamp "will be sold at the price of a single-piece First-Class Mail International first ounce machinable letter, and have a postage value equivalent to the price of a single-piece First-Class Mail International first ounce machinable letter in effect at the time of use." Notice at 19. As the international counterpart to the domestic Forever stamp introduced in 2007, the proposed International Forever stamp will remain valid for postage regardless of future rate increases.

Handling charge for Inbound Direct Entry of Foreign Origin First-Class Mail. The Postal Service proposes a 0.1 cent handling surcharge applicable to foreign-origin, inbound direct entry of single-piece First-Class Mail. Inbound First-Class Mail subject to the handling charge consists of inbound letterpost items that are tendered by foreign postal operators for direct entry into the Postal Service's domestic First-Class Mail mailstream, provided each item upon entry bears postage paid indicia for single-piece First-Class Mail letters, cards, flats or parcels, and pays the 0.1 cent handling charge. The Commission finds the classification changes reasonable and shall incorporate the substance of these changes into the draft Mail Classification Schedule.

D. Promotional Pricing

The Postal Service proposes to offer five seasonal promotional pricing incentives within First-Class Mail: Mobile-Coupon/Click-to-Call Promotion (March 1, 2013 to April 30, 2013); BRM/CRM Promotion (April 1, 2013 to June 30, 2013); Emerging Technology Promotion (August 1, 2013 to September 30, 2013); Picture Permit Promotion (August 1, 2013 to September 30, 2013); and Mobile Buy-It-Now Promotion (November 1, 2013 to December 31, 2013).

Mail to Mobile category. The Mobile-Coupon/Click-to-Call Promotion, Emerging Technology Promotion, and the Mobile Buy-It-Now Promotion are included in the Mail to Mobile category. The Mobile Coupon/Click-to-Call Promotion seeks to increase the value of direct mail by further highlighting the integration of mail with mobile technology. Participants receive a two percent discount on the qualifying postage for First-Class Mail and Standard Mail presort or automation letters, postcards, and flats which include a two-dimensional mobile barcode inside or on the mailpiece. The barcode must either lead the recipient to a coupon that can be stored on a mobile device, or enable the recipient to connect by telephone to another person or call center via a mobile device.

The Emerging Technology Promotion intends to promote awareness of how innovative technology, such as Near Field Communication, Augmented Reality, and Authentication, can be integrated with a direct mail strategy to enhance the value of direct mail. Participants receive a 2 percent discount on the qualifying postage for First-Class Mail and Standard Mail presort or automation letters, postcards, and flats that include print that allows the recipient to engage in one of the following: an augmented reality experience facilitated by a smartphone or computer, authentication of the recipient's identity, or an experience facilitated via Near Field Communication.

The Mobile Buy-it-Now Promotion is designed to encourage mailers to adopt and invest in technologies that enhance how consumers interact and engage with mail, and demonstrate how direct mail can be a convenient method for consumers to do their holiday shopping. The promotion provides a 2 percent discount on the qualifying postage for First-Class Mail and Standard Mail presort or automation letters, postcards, and flats which include a mobile barcode inside or on the mailpiece. This barcode must facilitate a mobile optimized shopping experience.

The Postal Service seeks to recover some of the revenue forgone from these promotions by factoring the lost revenue into the price cap calculation. The volumes from the 2011 Mobile Barcode Promotion serve as the basis for this calculation.

Picture Permit category. The Picture Permit category consists of the Picture Permit Promotion. During the promotion period, the Postal Service will eliminate the Picture Permit charge for First-Class Mail and Standard Mail presort or automation letters and postcards that are sent during the established program period, and that include approved Picture Permit Imprint Indicia. The Postal Service does not seek to recover the revenue forgone from this promotion.

Earned Value Reply Mail category. The Earned Value Reply Mail category consists of the BRM/CRM Promotion. Participants receive a rebate of 2 cents per piece on all BRM and CRM pieces that meet program requirements and are returned to the registered customer during the program period. The Postal Service uses estimates of BRM and CRM volumes that qualify for this promotion to calculate the revenue forgone from this promotion.

Comments on promotional pricing. The Public Representative and Valpak note that the Postal Service has never before included revenues foregone due to promotional pricing in its price cap calculations. PR Comments at 5; Valpak Comments at 42. The

Public Representative, Valpak, and Pitney Bowes suggest that the policy and technical issues raised by promotional pricing be thoroughly evaluated in a separate docket. Pitney Bowes Comments at 8; PR Comments at 6; Valpak Comments at 8.

The Public Representative does not object to the Postal Service's approach to accounting for promotional pricing in this docket because of the procedural difficulties that would be created by instructing the Postal Service to remove the revenue forgone from its price cap calculations. PR Comments at 5.

Pitney Bowes further highlights policy and technical (price cap) issues raised by the Postal Service's current approach to accounting for promotional pricing, but similarly argues that the promotions should be approved at this time. Pitney Bowes Comments at 7-8.

Valpak notes the Postal Service's inconsistent treatment of revenue forgone by including revenue forgone in the calculation of average price increases for some promotions at the class level, but not at the product level. Valpak Comments at 45. Valpak urges the Commission to keep with the established practice of not allowing inclusion of revenue forgone in the price cap calculation at this time. *Id.* at 47.

While generally supporting promotions as an important pricing tool, NAPM argues that the Postal Service should not be permitted to recover revenue in excess of the price cap in the event revenue forgone projections overstate the revenue "leakage" associated with the promotions. NAPM Comments at 6.

NPPC contends that more advance notice of promotional pricing is necessary because NPPC has been advised by many of its members that postal budgets have already been set for 2013. NPPC Comments at 18. NPPC also expresses concern of shifting the risk of failed discounts from the Postal Service to mailers because of the accounting methodology of promotions within the price cap. *Id.* at 19-20.

Commission analysis. Although this is the first time that the Postal Service is including revenues foregone due to promotional pricing in its price cap calculations, the Postal Service demonstrates compliance with rules 3010.14(b)(1) through (4).

Generally, the concern with including promotions in the cap calculation is that if the volume weights used in the cap calculation are overstated, the price authority created would be overstated as well. In Docket No. R2011-1, classification and price adjustments for First-Class and Standard Mail Initiatives, the Commission concluded that expected new volume should not be considered in the price cap calculation. Specifically, the Commission stated: "[a]djustments to the volume weights [used to measure the percentage change in rates]...should not attempt to anticipate changes in mailers' behavior in response to changes in prices or classifications."[20]

In the instant docket, the Postal Service seeks to recover the forgone revenue resulting from the promotions being offered in calendar year 2013 where historical volumes are available for the calculation of the effect of the price change resulting from the promotions on the price cap. Thus, the Postal Service does not rely on forecasts of expected volume to establish the volume weights in the cap calculation.

For the Mail to Mobile category, the Postal Service uses actual volumes from the 2011 Mobile Barcode Promotion (July and August, 2011), which took place during the hybrid year period used in this filing. Since the volume the Postal Service uses in the cap calculation only includes one Mail to Mobile Promotion, it is likely to understate, not overstate the volume from the three promotions proposed in the Mail to Mobile category. For the Earned Value Reply Mail Promotion, the Postal Service uses historical data to identify BRM and CRM volumes that would qualify for the promotion.

The Postal Service presents its price changes by product for First-Class Mail. These price changes by product do not include the effect of the promotions included in

[20] Docket No. R2011-1, Order No. 606, Order Approving Market Dominant Classification and Price Changes, and Applying Price Cap Rules, December 10, 2010, at 19.

the calculation of the price change for the class. When calculating the price change for the class, the Postal Service accounts for the promotions by applying a separate adjustment. In response to CHIR No. 4, question 6, the Postal Service provides price changes by product that incorporate the revenue forgone from the discounts offered in the promotions.

For the reasons discussed above, the Commission finds that the Postal Service's price cap treatment of promotions is permissible so long as volumes are properly ascribed to the appropriate products.

E. International First-Class Mail

First-Class Mail International (FCMI) consists of two products: Outbound Single-Piece First-Class Mail International and Inbound Single-Piece First-Class Mail International. The Postal Service calculates a combined price increase for First-Class Mail International of 7.923 percent.[21] The calculated price increase for Outbound Single-Piece First-Class Mail International letters and flats is 14.338 percent.[22] The percentage change in price for outbound single-piece international cards is positive. *Id.* For Inbound Single-Piece First-Class Mail International, the percentage change in price is negative. *Id.* The non-machinable surcharge of 20 cents for Outbound Single-Piece First-Class Mail International letters is unchanged.

The Postal Service also introduces a handling surcharge of $0.001 for foreign-origin, inbound direct entry of single-piece First-Class Mail tendered by foreign postal

[21] USPS-LR-R2013-1/1, First-Class Mail Cap Compliance, Excel File CAPCALC-FCM-R2013.xls.

[22] Notice at 19; *see also* Library Reference USPS-LR-R2013-3/NP1 (non-public), First-Class Mail International Cap Compliance, Excel file CAPCALC-FCMI-R2013.xls, worksheet tab FCMI TOTAL PRICE INCREASE.

operators, subject to the terms of an authorization arrangement.[23]

The Postal Service maintains that increasing the price of outbound single-piece letters "significantly above" the First-Class Mail average of 2.570 percent is necessary "to increase contribution and improve cost coverage for FCMI Letters at the one-ounce weight step." Notice at 19. The above-average price increase is also intended "to accommodate the introduction of the International Forever stamp." *Id.*

The price cap calculation for Outbound Single-Piece First-Class Mail International letters, cards, and flats is based upon the hybrid fiscal year developed from quarterly outbound volumes reported in the International Market Dominant Products Billing Determinants.[24] Because quarterly inbound data are not available, the price cap calculation for Inbound single-piece First-Class Mail International is based upon FY 2011 inbound volume and weight totals presented in the International Cost and Revenue Analysis (ICRA) report.[25]

The Postal Service's price cap calculation for Outbound Single-Piece First-Class Mail International conforms to the Commission's accepted methodology. By contrast, its price cap calculation for Inbound Single-Piece First-Class Mail International includes two new changes to the price cap calculation methodology established in last year's price adjustment proceeding. First, the Postal Service relies on a different data source for inbound volume and weight totals. The use of these inbound volume and weight totals results in a slightly smaller decease in price than if the Postal Service had used

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[23] *Id.* at 54. The Postal Service inadvertently omitted the $0.001 handling charge from its price cap calculation for First-Class Mail. Response to CHIR No. 1, question 17. The Postal Service subsequently filed errata to Library Reference USPS-LR-R2013-1/1, First-Class Mail Cap Compliance. United States Postal Service Notice of Errata to USPS-LR-R2013-1/1, November 8, 2012, Excel file CAPCALC-FCM-R2013_Errata.xls

[24] International Market Dominant Products Billing Determinants are one of several Postal Service periodic reports generally filed with the Commission on a quarterly or monthly basis that provide information on the financial or operational status of the Postal Service. *See* http://www.prc.gov/prc-pages/library/usps-periodic-reports/default.aspx?gridpart=periodic.

[25] *See* Docket No. ACR2011, Library Reference USPS-LR-FY11-NP2.

the same data source for inbound volume and weight totals used in the last proceeding. The Postal Service also includes some negotiated terminal dues rates from bilateral agreements with certain foreign postal operators rather than the UPU terminal dues rates.[26]

Commission analysis. The Commission accepts the Postal Service's explanation for above-average increases for the Outbound Single-Piece First-Class Mail International product and approves the price changes proposed by the Postal Service for First-Class Mail International. However, with respect to the price cap calculation for Inbound Single-Piece First-Class Mail International, the Commission finds that the Postal Service's departures from the accepted methodology are not explained on this record. In the absence of an adequate explanation for these changes, the Commission continues to rely on the accepted methodology underlying last year's adjustment in Docket No. R2012-3 when calculating the price cap for Inbound Single-Piece First-Class Mail International.

Applying the accepted methodology results in a revised price increase for First-Class Mail International of 7.627 percent compared to the 7.923 percent calculated by the Postal Service. This small percentage decrease has little impact on the overall percentage change in price for First-Class Mail as a whole, although it generates a small increase of 0.002 percent in unused new pricing authority for the class.[27]

F. Additional Comments

Consideration of classification changes within price adjustment dockets. The Public Representative expresses concern that presenting promotional pricing proposals in the context of an expedited price filing does not provide sufficient time for interested

[26] Terminal due rates are paid by foreign postal operators to the Postal Service for delivery of Inbound First-Class Mail International (letterpost) in the United States.

[27] Additional explanation and supporting calculations appear in Library Reference PRC-LR-R2013-1/NP1.

parties to review the proposals. PR Comments at 4. He suggests that decisions on these proposals be deferred subject to the provision of additional information in conformance with 39 CFR 3010.14(b). *Id.* at 5.

The Commission encourages the Postal Service to file classification changes that may be complex or potentially controversial separately from annual price adjustments. In recent years, the Postal Service has filed proposals to shift products from market dominant to competitive separate from rate filings and then provided new rates after the change was previously approved. Relatively minor classification changes may be accommodated within the context of annual price adjustments. However, if questions concerning supporting data or policy issues arise, the expedited schedule of annual rate adjustments may not allow sufficient time to review certain classification proposals. This may result in deferral of the proposals, and ultimately delay implementation.

Timing of price adjustment filings. The Public Representative notes that in previous years the Postal Service initiated price adjustments after an Annual Compliance Report (ACR) was issued. PR Comments at 8. He argues that this allowed closer alignment of discounts with avoided costs. He contends that with this year's price adjustment preceding the ACR, the Commission will not know whether the discounts will be better aligned, or whether there will be substantial departures from the principles of efficient component pricing. *Id.* at 9.

Pitney Bowes commends the Postal Service for simultaneous filing of the market dominant and competitive price adjustments and for providing substantial advance notice (108 days) to enable the mailing community to prepare for the price changes. Pitney Bowes Comments at 1.

The Commission recognizes that the timing of ACRs in relation to annual price adjustments influence the alignment of discounts with avoided costs. The Commission further recognizes that the Postal Service has pricing flexibility that allows it to determine the timing of its price adjustments.

Passthroughs exceeding 100 percent. The Public Representative states that the large number of passthroughs exceeding 100 percent appearing every year are problematic and should be addressed by the Commission. PR Comments at 10. He argues for the rejection of passthroughs that substantially disadvantage one group of mailers relative to others, or which create substantial entry barriers to worksharing competition. *Id.* The Commission finds within First-Class Mail, the Postal Service has provided adequate justification for each passthrough exceeding 100 percent.

Pricing incentives. NAPM encourages the Postal Service to create pricing incentives to help drive adoption of Full-Service Intelligent Mail barcodes (IMb). NAPM Comments at 6-7. It notes the 2014 mandate requiring the application of IMb in order to receive all automation discounts, and the mailer's costs of implementing and maintaining the information technology infrastructure necessary to support IMb. *Id.*

The Commission encourages mailers to work with the Postal Service to create price incentives that benefit both the mailers and the Postal Service.

Service Standards. NPPC notes the Postal Service's recent proposals for reductions in service standards.[28] It suggests a separate proceeding to consider the effects of change in service in regard to the price cap. NPPC Comments at 22.

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[28] *See* Docket No. N2012-1, Advisory Opinion on Mail Processing Network Rationalization Service Changes, September 28, 2012.

IV. STANDARD MAIL

A. Introduction

This section discusses the proposed initial price adjustments for each product within Standard Mail, worksharing relationships, and mail classification changes. The Commission is remanding all Standard Mail prices to the Postal Service so that it may revise Standard Mail prices consistent with the FY 2010 ACD directives. The Commission approves all proposed worksharing relationships and classification changes. However, the Postal Service may use its pricing flexibility to modify the workshare discounts and classification changes when setting prices consistent with the FY 2010 ACD's directives, statute, and applicable regulations.

There are six products in the Standard Mail class: Letters; Flats; Parcels; High Density and Saturation Letters; High Density and Saturation Flats and Parcels; and Carrier Route. The Postal Service calculates a price adjustment authority for the Standard Mail class of 2.570 percent, and proposes to increase rates for Standard Mail, on average, by 2.541 percent. Errata to Notice at 1. The Postal Service does not use any of the -0.380 percent banked pricing authority. Notice at 6. The Postal Service reports the distribution of percentage price changes for products within Standard Mail as follows:

Table IV-1

Standard Mail Product Price Changes[29]

Product	Price Changes %
Letters	2.610
Flats	2.416
Parcels	3.081
High Density/Saturation Letters	2.059
High Density/Saturation Flats and Parcels	2.092
Carrier Route Letters, Flats and Parcels	2.907
Overall	2.541
Source: PRC-LR-R2013-1/6.	

The Commission finds the Postal Service's planned price adjustments for Standard Mail comply with the price cap limitations specified in 39 U.S.C. 3622(d). New unused authority created in this proceeding equals the unused portion of the annual limitation of 0.029 percent. The sum of all unused rate adjustment authority for Standard Mail, from the instant price adjustment and previous price adjustments, now equals -0.351 percent.

[29] Response to CHIR No. 5, question 5. To ensure consistency and transparency, the price adjustments reflect the adjusted percentage increase for each product and the class.

B. Standard Mail Flats Rates

The Postal Service proposes below-average rate increases for Standard Mail Flats. For the reasons stated below, the Commission finds that the Postal Service has failed to take the remedial steps identified by the Commission in its FY 2010 ACD[30] to remedy non-compliance with 39 U.S.C. 101(d).

The Commission finds the proposed rates for Standard Mail Flats are in conflict with the directives of the FY 2010 ACD. In recognition that the Postal Service has the authority and flexibility to adjust any Standard Mail rates in order to comply with the price cap, the Commission therefore remands Standard Mail rates to the Postal Service for revision consistent with the FY 2010 ACD directives.

1. Background

The Postal Service filed its Annual Compliance Report (ACR) for FY 2010 on December 29, 2010.[31] Upon receipt of the report, the Commission was required to perform a written ACD within 90 days "as to—(1) whether any rates or fees in effect during such year (for products individually or collectively) were not in compliance with the applicable provisions of this chapter...; or (2) whether any service standards in effect during such year were not met." 39 U.S.C. 3653(b)(1) and (b)(2).

In the FY 2010 ACD, the Commission found that the rates for Standard Mail Flats did not comply with section 101(d)'s mandate that "[p]ostal rates shall be established to apportion the costs of all postal operations to all users of the mail on a fair and equitable basis." 39 U.S.C. 101(d). It directed the Postal Service to "increase the cost coverage of the Standard Mail Flats product through a combination of above-average price

[30] Docket No. ACR2010, Annual Compliance Determination, March 29, 2011 (FY 2010 ACD).

[31] United States Postal Service 2010 Annual Compliance Report, December 29, 2010 (FY 2010 ACR).

adjustments, consistent with the price cap requirements, and cost reductions until such time that the revenues for this product exceed attributable costs." FY 2010 ACD at 106.

The Postal Service appealed this directive in *United States Postal Service v. Postal Regulatory Commission*, 676 F.3d 1105 (D.C. Cir. 2012). In the appeal, the Postal Service argued that the Commission's reliance upon the mandate in section 101(d) was outside the scope of its authority. *Id.* at 1107. It also argued that the Commission's determination was arbitrary and capricious. *Id.*

Subsequently, the court found that the Commission acted within its statutory authority by considering the general standards of section 101(d) in an annual compliance determination, "at least in extreme circumstances." *Id.* at 1108. However, the court also questioned whether the remedy imposed by the Commission on Standard Mail Flats would continue to be appropriate if cost coverage were to improve. *Id.* at 1106-07. On April 17, 2012, the court remanded the case to the Commission "for a definition of the circumstances that trigger section 101(d)'s failsafe protection, and for an explanation of why the particular remedy imposed here is appropriate to ameliorate that extremity...." *Id.* at 1110.

On August 9, 2012, the Commission issued Order No. 1427 in response to the court's mandate.[32] The Commission clarified that its analysis of the circumstances that would trigger section 101(d) depended on the totality of the circumstances presented. The Commission explained that it would not automatically find the Postal Service out of compliance anytime rates for a product fail to cover attributable costs. *Id.* at 4. It explained that its finding in the FY 2010 ACD was based on several factors, including:

> a significant and growing cost coverage shortfall; duration of the shortfall over a significant period; evidence that the cost coverage shortfall was likely to increase further; a significant adverse impact on users of other mail products (some of whom could be competitors of mailers of the subsidized mail product) requiring

[32] Docket No. ACR2010-R, Order on Remand, August 9, 2012 (Order No. 1427).

> subsidization of the non-complying product; failure of the Postal Service to address the shortfall by rate increases, cost decreases, or a combination thereof, despite the capability to do so; and failure of the Postal Service to provide an adequate explanation for not taking necessary remedial steps designed to ameliorate the cost coverage shortfall.

Id. at 9; 676 F.3d at 1107 (citing Respondent's Brief at 29).

The Commission provided counter-examples where an extreme case may not be found, including situations where "the Postal Service had not yet had a reasonable opportunity to remedy the shortfall" or "if the Postal Service were to demonstrate that price increases would be counterproductive under the statutory price cap or that cost reductions were not feasible." *Id.* at 10. Finally, it provided further explanation to justify the remedy imposed in the FY 2010 ACD and explained that in the future, Standard Mail Flats may cease to be an extreme case despite less than 100 percent cost coverage "provided the Postal Service has either taken adequate steps toward the elimination of the shortfall or presented adequate reasons to explain the shortfall." *Id.* at 13.

Proposed Standard Mail Flats Rates for FY 2013. In the Notice, the Postal Service states that "[l]etters receive an above-average increase, while Flats receive an average (at cap) increase." Notice at 20. It asserts that these pricing decisions reflect a balance among: (a) the Commission's findings in its FY 2010 ACD, (b) the Postal Service's concern over the health of the catalog industry, and (c) "the Postal Service's belief that above-average price increases for Flats (at the expense of letters) will impair its ability to enhance revenue and contribution under the statutory price cap (Objective 5)." *Id.*

To support its claims that its Standard Mail pricing decisions will improve net contribution, it presents a Standard Mail Contribution Model (Contribution Model) that purports to show that an above-average increase for Standard Mail Letters and an average increase for Standard Mail Flats increase total contribution by $5 million. *Id.* at 22-23. It contends that this pricing approach moves Flats toward 100 percent cost coverage and captures the revenue available under the price cap. *Id.* at 23. Further, it states that following the remedy ordered by the Commission, *i.e.*, that Standard Flats cost coverage be increased through a combination of above-average price adjustments and cost reductions, "would force [it] to use precious cap space in an attempt to boost Flats cost coverage." It contends "such efforts" could have "negative long-term effects on the ability of Standard Mail to contribute to covering network costs." *Id.* at 23-24.

The Postal Service also asserts that its pricing decision for Flats was influenced by the need to manage the price differential between Standard 5-Digit automation Flats and Carrier Route Flats. It states that had it given a larger price increase to Flats, "it would be forced to increase Carrier Route prices...even further." *Id.* at 24. It claims that it has allowed the price differential between the two products to grow from 8.2 to 8.3 cents, but it does not intend to create a wider gap in the future. *Id.*

Finally, the Postal Service states that when taking into account additional costs savings realized from the realignment of its mail processing network (Network Rationalization), the proposed price changes will set Flats on a sustainable path toward 100 percent cost coverage. *Id.* It estimates that cost coverage will modestly increase in FY 2012 and continue increasing in FY 2013. *Id.* at 24-25.

Valpak's Motion to Strike. On October 22, 2012, Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. (Valpak) filed a Motion to Strike the Standard Mail price adjustments in the Notice. Valpak alleges that the Standard Mail price adjustments proposed in the Notice are *prima facie* unlawful and violate prior Commission orders, the Postal Accountability and Enhancement Act (PAEA), and 39 U.S.C. 101(d). Valpak Motion to Strike at 1.

According to Valpak, the Postal Service was required to comply with the Commission's directive to file an above-average price increase in the subsequent rate adjustment. Instead of doing so, the Postal Service proposed a "balanced pricing approach", setting forth prices for Standard Flats that were less than above-average.

Id. at 7. Valpak contends that it is immaterial whether the Postal Service can demonstrate that price increases would be counterproductive, because two findings of non-compliance have already been made—in the FY 2010 ACD and the FY 2011 ACD. *Id.* at 8.

Additionally, Valpak argues that the Postal Service's proposed price adjustments are deficient in that they ignore products' elasticities as well as the effect on Standard Mail products other than Standard Mail Letters. *Id.* It claims that in addition to being *per se* illegal, the proposed adjustments do not reduce the cross-subsidy from other Standard Mail products to Standard Mail Flats. *Id.* at 9.

Valpak requests the Commission strike the Standard Mail price adjustments as *per se* unlawful, in violation of its order in the FY 2010 ACD and illegal under the PAEA, with leave for the Postal Service to notice and file new Standard Mail price adjustments based around a meaningfully above-average price increase for Standard Mail Flats along with corresponding reductions in other Standard Mail prices. *Id.* at 11.

Postal Service reply. The Postal Service filed its response to the Valpak Motion to Strike on October 31, 2012.[33] It raises both procedural and substantive objections to the motion.

Procedurally, it claims that the Valpak Motion to Strike inappropriately attempts to circumvent the public comment period by demanding that the Commission act on the Postal Service's proposal prematurely. Postal Service Response at 3. This approach alleges the Postal Service would deprive the public of the opportunity to comment on the proposed rates. *Id.*

[33] Response of the United States Postal Service in Opposition to Valpak's Motion to Strike Standard Mail Price Adjustment from Notice of Market-Dominant Price Adjustment, October 31, 2012 (Postal Service Response). The Postal Service Response to Motion to Strike was originally due on October 29, 2012, but due to weather related closures on October 29 and 30, the Postal Service filing is considered timely.

The Postal Service also claims that its proposal for Flats rates do comply with the Commission's remedial pricing orders. *Id.* at 4. It reiterates its interpretation of the language of Order No. 1427 providing an exception to a finding of an extreme case if the Postal Service could demonstrate that price increases would be counterproductive under the statutory price cap. It argues that the Notice explains why significant price increases to Standard Mail Flats would be counterproductive under the price cap. *Id.* at 5. It explains its belief that any price adjustment that moves the Flats product toward 100 percent cost coverage simultaneously reduces the intra-class subsidy. *Id.*

Participant comments. The Commission received seven comments related to the proposed pricing of Standard Flats.[34] L.L. Bean, Inc.,[35] the Association for Postal Commerce,[36] the National Postal Policy Council,[37] Pitney Bowes,[38] the American Catalog Mailers Association,[39] the Public Representative,[40] and Valpak[41] all commented on this issue.

L.L. Bean expresses concern about the fixed pricing differential that the Postal Service wants to maintain between Carrier Route and Flats. It states that because the Postal Service claims it would be "forced" to increase Carrier Route prices if it increased Flats prices, "this pricing approach holds Carrier Route hostage to any further increases

[34] Comments were originally due on October 31, 2012, but due to weather related closures on October 29th and 30th, the deadline was extended to November 1, 2012 by Order No. 1522.

[35] Response of L.L. Bean, Inc., Valpak Motion to Strike Standard Mail Price Adjustment, October 31, 2012 (L.L. Bean Response to Motion to Strike).

[36] Comments of the Association for Postal Commerce, October 31, 2012 (PostCom Comments).

[37] Comments of the National Postal Policy Council, November 1, 2012 (NPPC Comments).

[38] Comments of Pitney Bowes Inc., November 1, 2012 (Pitney Bowes Comments).

[39] Comments of the American Catalog Mailers Association, November 1, 2012 (ACMA Comments).

[40] Public Representative Comments in Response to United States Postal Service Notice of Market Dominant Price Adjustments, November 1, 2012 (PR Comments).

[41] Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Comments on the United States Postal Service Notice of Market-Dominant Price Adjustment, November 1, 2012 (Valpak Comments).

in Flats prices." L.L. Bean Response at 2. It disagrees with the contention that this pricing differential is forced upon the Postal Service, and believes that the approach contravenes the interest of not only catalog mailers, but also the Postal Service itself. *Id.* It urges the Postal Service to focus on ways to make Carrier Route a more viable product for the catalog industry and plans to pursue reformulations to allow more flexible pricing of this product. *Id.* at 3. In the meantime, however, L.L. Bean opposes the Valpak Motion to Strike because it believes that it would likely lead to higher price increases for Carrier Route Flats. *Id.*

PostCom suggests that organic changes within the industry favor taking a wait-and-see approach to Flats prices. PostCom Comments at 2. It states that due to improvements in price, co-mailing, and co-palletization, a substantial portion of Flats volume (including catalogs), has migrated to Carrier Route. *Id.* The current proposed prices are expected to continue that shift. *Id.* at 1-3. It states that regardless of whether a worksharing relationship between Flats and Carrier Route exists, the three factors enumerated above will drive migration away from Flats and to Carrier Route pieces. *Id.* at 4. It recommends that the Commission direct the Postal Service to track this migration, study its causes and effects, and only take action once a clearer picture of mailing patterns emerges. *Id.* at 4-5.

PostCom also questions the extent of the Commission's authority to alter prices that comply with the price cap in a rate adjustment proceeding, suggesting that the Commission may only direct the Postal Service to modify its prices for other reasons by instituting a complaint proceeding on its own motion. *Id.* at 3.

NPPC identifies the disproportionate price increases on Standard Letters relative to Standard Flats as a recurring problem. NPPC Comments at 14. It asserts that the noticed Flats prices fail to comply with the Commission's remedial orders and will continue the intra-class cross-subsidy. *Id.* It expresses concern about the Postal Service's reliance upon unproven future cost savings from network rationalization as justification for below-cost rates for Flats. It contends that prices should be set on the basis of known, current costs, and that prices should be adjusted in the future if anticipated cost savings are realized. *Id.* at 15.

Pitney Bowes argues that the assumptions underlying the Postal Service's Contribution Model are theoretically unsound, noting that the impact of alternative pricing proposals on profitability depends not only on volume trends, but also on the relative profitability and price sensitivity of individual products. Pitney Bowes Comments at 4.

ACMA opines that the substantial increases in Standard Mail Flats costs should be explored and until this step is taken, a conservative approach to increasing Standard Flats prices is prudent. ACMA Comments at 7, 15. Additionally, ACMA's comments included a survey reflecting consumer attitudes and opinions on catalogs and predictive modeling on consumer behavior.[42]

The Public Representative supports Valpak's Motion to Strike, claiming that the losses from the shortfall in institutional cost coverage will continue to mount if the proposed prices are accepted. PR Comments at 13. However, the Public Representative suggests that the Commission order a specific remedy and direct the Postal Service to reach 100 percent compliance by setting reasonable price increases for Standard Mail Flats over a measurable time frame. *Id.* at 15-17.

Valpak provides comments that elaborate on the assertions in its motion to strike and presents an extensive critique of the Postal Service's Contribution Model. According to Valpak, the Postal Service's model is flawed in the following ways: (a) it assumes that neither Flats nor Letters exhibits any elasticity of demand with respect to price (Valpak Comments at 19-22); (b) the assumptions underlying the Postal Service's

[42] These topics are not directly relevant to the limited issues before the Commission in a 39 CFR 3010 rate change proceeding. However, by filing at this time, ACMA has provided the Commission and the community with information which maybe germane to future Commission reports and cases.

model were designed to support its conclusion instead of reflecting sound economic principles (*id.* at 22-24); (c) if elasticity is incorporated into the model, it becomes clear that a higher increase for Flats leads to increased contribution (*id.* at 24-28); (d) pricing of Standard Mail does not maximize contribution and is arbitrary and capricious because it gives up potential additional contribution from increasing Flats prices for a smaller contribution from Letters (*id.* at 28-36); (e) a less than average price increase for Flats is unlikely to improve cost coverage (*id.* at 36-38); and (f) attributable costs vary with volume and, therefore, prices should be set to cover costs before Network Rationalization is complete, not afterward (*id.* at 38-41).

On November 9, 2012, the Postal Service submitted a pleading in response to the comments filed by Valpak and the Public Representative.[43] The Postal Service Reply Comments are intended to address Valpak's criticisms of the Postal Service's Contribution Model and include three alternative Contribution Models. The merits of this pleading and its timing are addressed in section VI., *infra*.

On November 13, 2012, Valpak filed an objection to the Postal Service Reply Comments, noting, among other things, that the Commission's rules do not permit the filing of reply comments in price adjustment dockets.[44]

2. Commission Analysis

In its FY 2010 ACD, the Commission found that Standard Mail Flats prices violated 39 U.S.C. 101(d) and directed the Postal Service to take specific remedial actions to address the persistent and worsening intra-class cross-subsidy. On review, the Commission's decision was left undisturbed. *United States Postal Service v. Postal*

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[43] Reply Comments of the United States Postal Service, November 9, 2012 (Postal Service Reply Comments). The Postal Service submitted a Motion of the United States Postal Service for Leave to File Reply Comments, November 13, 2012. The motion is granted.

[44] Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Objection to United States Postal Service Reply Comments, November 13, 2012.

Regulatory Commission, 676 F.3d 1105 (D.C. Cir. 2012). In lieu of proposing Standard Mail Flats prices that satisfy those remedial directives, the Postal Service contends that doing so "would impair its ability to enhance its revenue/contribution under the price cap." Notice at 21. The Commission is not persuaded that the rationale offered by the Postal Service justifies a waiver of the directive that cost coverage for Standard Mail Flats be increased through a combination of above-average price increases and cost reductions. The Commission finds that the planned Standard Mail Flats price increases are below the class average, and directs the Postal Service to file revised prices that comport with the remedial directives set forth in the FY 2010 ACD.

Valpak contends that the planned Standard Mail Flats prices are *per se* unlawful and urges the Commission to strike the Postal Service's Standard Mail Flats prices. Valpak Motion to Strike at 11. The Commission rejects the view that the prices are *per se* unlawful.

The Postal Service offers an explanation of why it should not comply with the Commission's directive in the FY 2010 ACD. Valpak correctly points out that the Postal Service's reliance on Order No. 1427's explanation of when an extreme case would not be justified, *i.e.*, further price increases would be counterproductive, is misplaced. Valpak Motion to Strike at 8. The Commission is not engaged in a de novo compliance determination. Rather, it is reviewing proposed rates for consistency with the statute and applicable Commission orders. Neither the ACD nor Order No. 1427 precludes the Postal Service from suggesting reasons supporting its pricing decisions. Changed circumstances may have a bearing on whether applicable remedial directives warrant a waiver. In this instance, the Commission finds the Postal Service's explanation unpersuasive. As discussed below, the new Postal Service Contribution Model is predicated on unsound assumptions which undermine the purported results.

ACMA contends that the Commission should not take action to enforce its 2010 ACD mandate because the costs reported for Flats are not accurate. ACMA

Comments at 15. ACMA advocates a "conservative approach" concerning increases for Standard Flats. *Id.* ACMA made similar arguments, and the Commission analyzed those arguments, in the FY 2011 ACD and the last general market dominant price adjustment in Docket No. R2012-3.[45] In this case the Postal Service does not propose, and the Commission does not require by this order, action that is inconsistent with the "conservative approach" ACMA advocates.

PostCom contends that, '[a]rguably, the Commission's sole review role in this docket is to ensure that the proposed prices comply with the cap at the class level, and the Commission may only direct the Postal Service to modify its prices for other reasons by instituting a complaint proceeding on the Commission's own motion." PostCom Comments at 3 (citation omitted).

There is no merit to this contention. The Commission's FY 2010 ACD findings, including its remedial directives, have been affirmed on appeal. It represents a lawful order which is binding on the Postal Service. Based on the record before it, the Commission finds the Postal Service's planned Standard Mail Flats prices inconsistent with the FY 2010 ACD and Order No. 1427.

a. Postal Service Compliance with FY 2010 ACD Directive

In the FY 2010 ACD, the Commission directed the Postal Service: to increase cost coverage for the Standard Mail Flats product through a combination of above-average price adjustments and cost reductions; to provide the Commission with an explanation of how the proposed prices would move Standard Mail Flats cost coverage toward 100 percent; and to provide a statement estimating the effect that the proposed

[45] *See* FY 2011 ACD at 115-19 ("The Commission encourages interested parties to continue to attempt to identify specific anomalies in conjunction with proposed solutions to correct methodologies that produce anomalous costs."); *see also* Order No. 987 at 27-28, 31-32, ("On the whole, the costing systems employed by the Postal Service and approved by the Commission produce reasonably reliable product costs for ratemaking purposes.")

prices would have in reducing the subsidy of the Standard Mail Flats product. FY 2010 ACD at 106-07. In this proceeding, the Postal Service neither proposes an above-average rate adjustment nor convincingly demonstrates that cost reductions will result in an increase in the cost coverage of the Standard Mail Flats product. It also fails to establish that the proposed prices would reduce the intra-class cross-subsidy.

The Postal Service's Standard Mail workpapers (USPS-LR-R2013-1/2) demonstrate that its proposed prices include a below-average price increase for Standard Mail Flats. The Postal Service's original workpapers did not distribute the revenue forgone from certain pricing promotions to calculate percentage increases by product. The Postal Service's assertion that it followed its prior practice is addressed below. *See* section IV., 2e. The failure to do so overstates the percentage increase by product. As a consequence, in its Notice, the Postal Service mistakenly represents that Standard Mail Flats price increases equal the class (cap) average. Notice at 20. When the effects of the promotional discounts are taken into account, Standard Mail Flats planned prices increase by 2.416 percent, and remain below the revised class average, 2.541 percent.[46]

In response to Commission Information Request No. 1, October 18, 2012 (CIR No. 1), the Postal Service states that it anticipates the cost coverage for Standard Mail Flats to increase to 83 percent in FY 2012 and 86 percent in FY 2013 due, in part, to estimated decreases in the average unit cost for Standard Mail Flats.[47] It asserts that "Network Rationalization will result in significant cost reductions for the Postal Service.... A significant share of these anticipated savings...will come from flats products." *Id.* at 4.

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[46] See Response of the United States Postal Service to Questions 1-5 and 7 of Chairman's Information Request No. 5, question 5, November 6, 2012 (Response to CHIR No. 5). The increases properly reflect the distribution of all of the revenue forgone from promotions to each Standard Mail product; *see also* United States Postal Service Notice of Errata to Notice of Market-Dominant Price Adjustment, November 8, 2012.

[47] *See* Response of the United States Postal Service to Questions 1-6 of Commission Information Request No. 1, question 2, File: StandardFlats.xls., October 23, 2012, (Response to CIR No. 1).

The Postal Service estimates the FY 2013 unit cost savings from Network Rationalization for Standard Mail Flats to be 0.56 cents. The response includes a worksheet, sourced to cost forecasts filed in Docket No. CP2013-3, showing the estimated savings.

These model outputs do not contain sufficient data for the Commission to substantiate the expected cost savings. The Postal Service did not provide supporting supplemental input files which contain all of the cost effect input factors and distribution key information used for each year of the cost forecast.[48] In short, the Postal Service fails to demonstrate that Standard Mail Flats average unit costs are likely to decrease.

In its comments, NPPC raised concerns about the Postal Service's "unproven future cost savings" as follows:

> NPPC members are among the many Standard Letter mailers that are disadvantaged by the current and proposed Standard Letter prices. And NPPC is rather concerned that the Postal Service is relying upon unproven future cost savings from network rationalization as a justification for below-cost rates for Standard Flats. It would be preferable to set prices on the basis of known, current costs, and moderate future prices in the future should anticipated cost savings, in fact, be realized.

NPPC Comments at 15.

In addition, in its Advisory Opinion on Mail Processing Network Rationalization Service Changes, September 28, 2012 (Advisory Opinion), the Commission found that the Postal Service's mail processing cost savings estimates were optimistic and that the actual savings could be much lower. Advisory Opinion at 90-91. The Postal Service does not address this issue in its response.

The Commission shares NPPC's concern about the Postal Service's reliance on unproven future cost savings as justification for below-cost rates for Standard Mail Flats.

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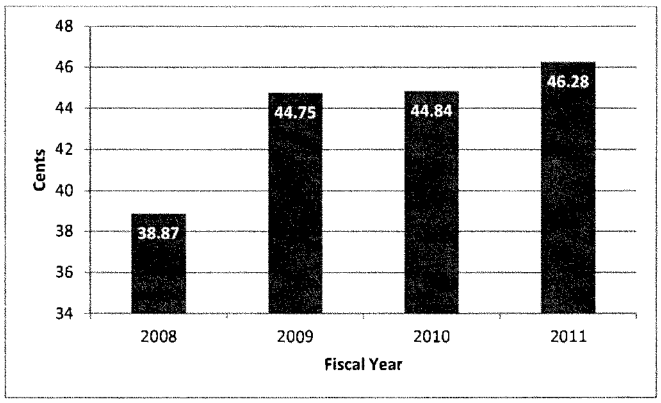
[48] The "cost effect input factors" refers to all of the different factors involved within the 10 cost roll forward effects (*i.e.*, cost level, non-volume workload, cost reductions, etc.).

NPPC Comments at 15. Figure 1 shows that since FY 2008, the unit cost of Standard Mail Flats has increased every year.

Figure 1: Standard Mail Flats Unit Cost



Below-cost pricing of Standard Mail Flats and the resulting negative contribution have been a persistent and growing problem since the passage of the PAEA. Since FY 2008, Standard Mail Flats have generated cumulative losses totaling $2.1 billion. On a unit cost basis, the loss per piece has grown from -2.2 cents to -9.5 cents. The Postal Service's planned below-average price increase for Standard Mail Flats does not appear to begin to ameliorate the problems which gave rise to the Commission's ACD finding of non-compliance. On remand, the Postal Service must comply with the directives of the FY 2010 ACD.

Market dominant price adjustment proceedings are, by statute and regulation, conducted under an accelerated timetable. *See* 39 U.S.C. 3622(d)(1)C); 39 CFR 3010.13(b). The Postal Service is aware of the FY 2010 ACD's remedial directives. It acknowledges that it understand that its planned price increases for Standard Mail Flats do not comply with those directives. Instead, the Postal Service offers an explanation for its pricing decisions which, as noted, the Commission finds unpersuasive.

In offering an explanation for its pricing decisions, the Postal Service is, in effect, seeking a waiver of the FY 2010 ACD directives. Under the circumstances, it was incumbent on the Postal Service to provide full documentation to substantiate its claims at the outset of the proceeding. It failed to do so. The Postal Service's filing of reply comments, which are not permitted by rule under the expedited proceeding of a price adjustment, compromises both interested persons' ability to comment and the Commission's time for review. The Postal Service should have avoided the prejudice to parties and the Commission by petitioning for relief a reasonable period in advance of its price adjustment filing. Nevertheless, the Commission has made every effort to ensure a complete record and meaningful opportunity for all parties, including the Postal Service, to comment on this pivotal issue.

b. Postal Service Standard Mail Contribution Model

The Postal Service argues that giving Standard Mail Flats an above-average increase would reduce the overall contribution for Standard Mail. The Postal Service contends that as a result, it should not be required to comply with the Commission's FY 2010 ACD directive that it improve Standard Mail Flats cost coverage through a combination of above-average price increases and cost reductions. It projects that its Standard Mail Flats pricing (as contrasted with the remedial directive of an above-average increase) will generate approximately $4.9 million in additional contribution. The Contribution Model on which this projection is based is flawed as described below, producing results that are contrary to universally accepted economic principles.

The Postal Service's Contribution Model assumes that Standard Mail Letters volume will increase 4 percent annually while Standard Mail Flats volume will decrease 7 percent annually. The Contribution Model assumes that regardless of price changes, future annual volume changes will be exactly the same as the Postal Service experienced during the last 2 years.[49] This assumption is unfounded and unsupported. Recent data indicate these assumptions are erroneous.

The Postal Service's latest FY 2012 quarterly volume data (through June 2012) show that Standard Mail Letters declined 7.8 percent over the same period last year (SPLY) and Standard Mail Flats declined 12.7 percent over SPLY.[50] These FY 2012 results contradict the assumptions used in the Postal Service's Contribution Model and highlight the flaw in using a volume trend with only two data points to predict future volume growth.

The Postal Service's Contribution Model does not take into account current economic trends which are known to impact volume.[51] In contrast, the Postal Service's traditional Demand Analyses incorporate myriad factors, such as Gross Domestic Product, employment, Consumer Price Index (CPI), retail sales, broadband subscriptions, and population, known to affect demand for postal products.[52]

As Valpak and Pitney Bowes correctly note, the Postal Service's failure to use price elasticities leads to erroneous conclusions because it ignores the effect of price changes on volume. Valpak Comments at 19-28. Assuming price changes have no impact on volume could lead to the unrealistic conclusion that prices could increase exponentially without fear of losing a single mailpiece. Valpak Comments at 21; Pitney Bowes Comments at 4. This conclusion does not correspond with basic economic

[49] The Postal Service's volume trend is based on 3 years of data, or two data points, *i.e.*, the volume change from 2009 to 2010, and from 2010 to 2011.

[50] *See* Quarterly Statistic Report filed September 12, 2012 (Quarterly Statistic Report).

[51] The Postal Service asserts that failure to use its own-price elasticities does not sacrifice accuracy in its Standard Mail Contribution Model because it does not have different elasticities by shape. Response to CIR No. 1, question 3b. This assertion does not justify its omission of price elasticities from its Standard Mail Contribution Model.

[52] *See* 2012 Demand Analyses and Volume Forecast Materials for Market Dominant Products, January 20, 2012 (Postal Service Demand Analyses).

theory or proven postal demand scenarios. It is a well-established economic principle that price increases have a demonstrable impact on volume. This fundamental tenet is widely acknowledged and, indeed, has been used by the Postal Service for decades.

The Commission estimates the impacts of the scenarios presented in the Postal Service's Contribution Model using the established Postal Service Demand Analyses.[53] The Postal Service Demand Analyses estimate four different Standard Mail price elasticities: Regular, Nonprofit Regular, Enhanced Carrier Route, and Nonprofit Enhanced Carrier Route. These price elasticities reflect the effect of price changes on volume. Importantly, the Postal Service Demand Analyses also incorporate long-term volume trends and economic factors that impact volume changes. The Postal Service's Demand Analyses provide more robust results than its simplistic Contribution Model. Using these proven techniques, the Commission demonstrates that the Postal Service's contention—that an above-average increase for Standard Mail Letters and an average increase for Standard Mail Flats produce $4.9 million more in contribution than an alternative that complies with the 2010 ACD directives—is incorrect. In fact, an above-average price increase for Letters and an average price increase for Flats would result in $5.8 million **less** contribution than complying with the 2010 ACD directives. *See* PRC-LR-R2013-1/1 and CIR No. 1, question 4.

Standard Mail consists of six products, but the Contribution Model considers pricing options for only two of those products. The Postal Service offers the Contribution Model to demonstrate how its pricing decisions (affecting two products) maximize contribution. Notwithstanding the models other flaws, due to the model's focus on only two products within the class, the results are inconclusive. If the Postal Service was truly attempting to maximize contribution from the Standard Mail class, it would need to take into account all Standard Mail products.

[53] *See* CIR No. 1, question 4; *see also* PRC-LR-R2013-1/1.

c. Postal Service Reply Comments

As noted above, on November 9, 2012, the Postal Service filed reply comments responding to criticisms of its Contribution Model by Valpak and the Public Representative. The Postal Service presents three "Alternative Contribution Models," which, unlike its original Contribution Model, include various assumptions about the price elasticities of the Standard Mail Letters and Flats products. The Postal Service asserts that, under each scenario, there is a "tipping point" between 3 and 7 years in the future, where the Postal Service would generate less cumulative contribution by raising Flats prices by a greater percentage than Letters. Postal Service Reply Comments at 3-4.

The Postal Service's analysis was presented at the conclusion of the case, after the comment period had closed, and past the point where parties or the Commission could thoroughly examine it. Upon initial examination it appears the analysis suffers from several significant flaws. First, each of the Alternative Contribution Models utilizes the same short-term volume trends used in the original Contribution Model. These trends are assumed to persist for every future year in each scenario. This assumption, which underlies the Postal Service's conclusion that, given a long enough time horizon, concentrating price increases on Letters would generate greater contribution, is contrary to historical volume trends, and the most recent data.

The Postal Service's analysis is a simple demonstration of a known characteristic of backward-weighted indices. If the volume of a product in the index increases from one year to the next, the use of an historical volume will tend to understate the revenue generated by a price increase on that product. This conclusion follows because the new, higher price will actually apply to more pieces than the index assumes. Conversely, if the volume of a product in the index decreases, the use of a historical volume will overstate the revenue generated by a price increase, because the new price will apply to fewer pieces than the index assumes. Given this characteristic of backward-weighted indices, the Postal Service's assertions could be read as suggesting that it would be counterproductive for it to do anything other than concentrate all of its available pricing authority on maximizing price increases for the fastest growing products in each class.

The most recent data available indicate that volume trends for Letters and Flats have already changed from those used in the Postal Service's Contribution Models.[54] The Alternative Contribution Models' assumption that a recent volume trend will continue 8 years into the future is overly simplistic and belied by a review of the prior 8-year period, which reveals the effect of then-existing economic and related factors on postal volumes.[55]

As with the original Contribution Model, the Alternative Contribution Models analyze only the Letter and Flat products, ignoring the four other products in Standard Mail. This construct, which vastly simplifies the number of possible combinations of price increases, forecloses the possibility that the Postal Service could implement its preferred price increases for Letters and, where necessary, implement slightly lower price increases for other (more price elastic)[56] products to keep Standard Mail below the price cap. The Postal Service's Contribution Model provides no insight as to whether such alternatives might generate even greater contribution.

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[54] The year-to-date 2012 Quarterly Statistic Report shows that Letters volumes have decreased 7.8 percent over SPLY and Flats volumes have decreased 12.7 percent over SPLY. *See* United States Postal Service Quarterly Statistic Report, September 12, 2012.

[55] The Alternative Contribution Models assume that unit costs will remain constant for 8 years. While the original Contribution Model employs a similar assumption, the problem is exacerbated in the former by the extended time period being considered.

[56] The own-price elasticity of Standard Regular (which includes commercial Letters and Flats) is -0.335, whereas the own-price elasticity of Standard ECR (which includes commercial Carrier Route and High Density/Saturation Letters and Flats) is -0.782. *See* Postal Service Demand Analyses.

d. Price Differential between Standard Mail Flats and Standard Mail Carrier Route

PostCom suggests that the Commission need not address Standard Mail Flats pricing issues in this proceeding. It contends that due to existing price incentives and improved mail preparation techniques "a substantial portion of flats volume—including catalogs—has migrated from Standard Mail Flats to Carrier Route." PostCom Comments at 2; *see also id.* at 3. Comparison of volume trends for the Standard Flats and Carrier Route products over the last three years does not conclusively demonstrate that this migration is occurring. The Postal Service, in signaling its intent to maintain the price differential between Standard Mail Flats and Carrier Route, disclaims use of its pricing authority to encourage further migration. Furthermore, migration from one product to another does not necessarily mitigate the fundamental problem of cross-subsidization.[57] In fact, in some circumstances, it could exacerbate the problem.[58]

PostCom suggests that the Postal Service be directed to monitor the impact of migration of Standard Mail Flats to Carrier Route. The Postal Service may wish to consider that suggestion. However, until it can be demonstrated that the migration from Standard Mail Flats to Carrier Route is, in itself, reducing the intra-class cross-subsidy, this consideration does not obviate the need to adjust prices.

L.L. Bean expresses concern regarding the fixed price differential between Carrier Route and Standard Mail Flats imposed by the Postal Service. L.L. Bean Response at 2. The Commission notes, and the Postal Service confirms, that there is no legal requirement to maintain a fixed differential. The Postal Service also acknowledges that no worksharing relationship, which might dictate a narrow price

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[57] The actual effect of an inter-product migration on the cost coverage of each product would depend on the specific revenue and cost characteristics of the mail that migrates.

[58] For example, lower cost pieces could migrate leaving higher cost pieces in the original product.

differential, exists between the two products.[59] The Postal Service has the pricing flexibility to set price differentials outside of worksharing relationships. However, the Postal Service's desire to maintain fixed price differentials between Carrier Route and Flats does not override the need to reduce the intra-class cross-subsidy. This Order should not be read as encouraging the Postal Service to increase or maintain the fixed pricing differential.

e. Errors and Discrepancies and Standard Mail Workpapers

Five Chairman's Information Requests were issued regarding: the exclusion of promotional discounts from product percentage change and nonprofit ratio calculations, the inclusion of pounds in ratios used to distribute pieces, the exclusion of pound revenue from calculations, the exclusion of a portion of Simple Sample revenue, inconsistent Mail Classification Schedule (MCS) language, and non-uniform discounts between commercial Standard Mail Flats and Nonprofit Flats.[60]

Each of these issues is discussed below. In most instances, errata were submitted to make corrections where necessary. Additional workpapers needed to support revised Standard Mail prices should incorporate these errata.

The Postal Service did not distribute the revenue forgone from promotions to each product as part of its Standard Mail price cap workpapers. *See* USPS-LR-R2013-1/2. In Response to CHIR No. 5, the Postal Service filed updated workpapers that

[59] Response of the United States Postal Service to Commission Information Request No. 1, October 23, 2012, at 12.

[60] The Postal Service responded to Chairman's Information Request No. 1 on October 26, 2012. Chairman's Information Request No. 2 was filed on October 24, 2012 (CHIR No. 2). The Postal Service responded to Chairman's Information Request No. 2 on October 26, 2012. The Postal Service responded to Chairman's Information Request No. 3 on November 1, 2012 (Response to CHIR No. 3). Chairman's Information Request No. 4 was filed on October 25, 2012 (CHIR No. 4). The Postal Service responded to CHIR No. 4 on November 1, 2012. Chairman's Information Request No. 5 was filed on October 31, 2012 (CHIR No. 5). The Postal Service responded to CHIR No. 5 on November 5, 2012 (Response to CHIR No. 5).

distribute the revenue forgone from promotions to individual Standard Mail products. The Postal Service states that its original filing presented "unadjusted" percentage increases for products, while it presented an "adjusted" percentage increase for the Standard Mail class. The "unadjusted" percentage increases by product do not account for all of the proposed prices offered for each product within the class.

In Response to CHIR No. 5, question 5, the Postal Service argues that it reported unadjusted percent changes of certain products in the past. The only two instances were in Docket Nos. R2011-2 and R2012-3, where the Postal Service was unable to disaggregate adjustments for the Intelligent Mail Barcode incentive and the Move Update Penalty among three products: High Density and Saturation Letters, High Density and Saturation Flats, and Parcels and Carrier Route. The Postal Service did not disclose that it was reporting unadjusted figures, and the Commission did not remark on the Postal Service's use of unadjusted figures. The Commission's rules provide a method for calculating the percentage change in rates for a class. *See* 39 CFR 3010.23. While the Commission rules do not specifically address the method to calculate a percentage change in rates by product, the Postal Service should use the same methodology as prescribed for a market dominant class of mail when calculating a percentage change for a market dominant product.

The Commission finds that use of "adjusted" percentage increases for each product is the most transparent method because it reflects all of the prices and discounts present for each product within the class.[61]

The Commission's FY 2010 ACD directive requires above-average increases for the Standard Mail Flats product. The percentage change in rates for each Standard

[61] It is worth noting that the weighted average of the "unadjusted" price increases for all Standard Mail products exceeds the price cap. In contrast, the weighted average of the "adjusted" price increases for all Standard Mail products equals the planned increase of Standard Mail. The Commission provisionally finds that the price increases proposed for the Standard Mail class satisfy the requirements of 39 U.S.C. 3622(d)(2)(A).

Mail product must include all price categories within that product, including promotions, for the Commission to evaluate accurately the percentage increase by product.[62]

The Postal Service's Standard Mail promotion workpapers include two flaws. First, when distributing promotion pieces to price cells, the Postal Service mistakenly includes pounds in its piece ratio. Second, the Postal Service does not include the revenue forgone from pounds in its price cap calculations. It acknowledges both of these errors and provides corrected workpapers in response to CHIR No. 5. *See* Response to CHIR No. 5, questions 1, 5, 7, at 7-12.

Additionally, in CHIR No. 5, question 7, the Commission notes that Carrier Route Simple Sample revenues were excluded from the Postal Service's price cap calculations. *See* CHIR No. 5, question 7. The Postal Service corrects this error in Response to CHIR No. 5.

The Postal Service's presentation of workshare discounts for commercial and nonprofit is not transparent. Attachment B to the Postal Service's Notice implies that all Letter and Flat commercial and nonprofit workshare discounts are the same.[63] However, the rate calculation worksheets apply workshare discounts to some rate categories that differ between commercial and nonprofit. In Response to CHIR No. 5, questions 8 through 13, the Postal Service explains that:

> The discounts in USPS-LR-R2013-1/2 show the Nonprofit discount, while Attachment B shows the Commercial discount. In both ACR and price adjustment filings, neither the Postal Service nor the Commission has compared Nonprofit discounts to avoided

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[62] *See* Reply of Alliance of Nonprofit Mailers to USPS Response to Chairman's Information Request No. 5, Question 2, November 8, 2012. For some previous promotional discounts, the Postal Service proposed, and the Commission approved, that the effects of the discounts be excluded from consideration of any impact on the price cap. The instruction in this Order to distribute promotional discounts to products applies where the discounts are included in determining compliance of the class with the price cap.

[63] *See, e.g.*, Attachment B Workshare_Final.xls, tab: Standard Mail Flats, titled: Workshare Discounts and Benchmarks—Standard Mail Flats (Commercial and Nonprofit).

> costs, so long as there is both a Commercial and Nonprofit category for that particular price category. Instead, just the Commercial discount is used to calculate the passthrough. Since the Nonprofit discounts are generally lower than the Commercial discounts, showing just the Commercial passthrough protects against over 100 percent passthroughs for both Commercial and Nonprofit.

This explanation is insufficient. All workshare discounts must be evaluated by the Commission for compliance with 39 U.S.C. 3622(e).[64] Merely setting nonprofit discounts lower than commercial discounts does not allow for transparent evaluation supporting a conclusion that the requirements of 39 U.S.C. 3622(e) are being met. When nonprofit and commercial discounts differ, the Postal Service must calculate separate passthroughs for those discounts. The Postal Service Attachment B workpapers must calculate passthroughs for each discount it offers.[65]

Finally, in Response to CHIR No. 3, questions 2 and 3, the Postal Service acknowledges inconsistencies in its MCS language. The Postal Service must resolve these inconsistencies in its response to this Order.

3. Conclusion

Based on this analysis, the Commission finds the proposed rates for Standard Mail Flats are in conflict with the directives of the FY 2010 ACD. In recognition that the Postal Service has the authority and flexibility to adjust any Standard Mail rates in order to comply with the price cap, the Commission therefore remands Standard Mail rates to the Postal Service for revision consistent with the FY 2010 ACD directives. There are

[64] *See* 39 CFR 3010.14(5). Pursuant to this rule, the Postal Service must also identify workshare discounts that are set substantially below their avoided costs.

[65] Notwithstanding its assertion that it no longer believes that the proposed High-Density Plus price tier should be added as a workshare discount, the Postal Service must provide the information requested in CHIR No. 1, question 5 in response to this Order. *See* Response to CHIR No. 1, question 5.

differing approaches available to the Postal Service when satisfying the remedial directives of the FY 2010 ACD.[66]

The Commission maintains a narrow scope of review in the accelerated proceedings reviewing market dominant price adjustments. The Commission's primary review concerns compliance with the market dominant price cap described in 39 U.S.C. 3622(d). The Commission is averse to inserting itself into the policy considerations of rate setting. However, it is incumbent on the Postal Service to follow lawful Commission directives. The Commission previously found a violation of the applicable statute and prescribed a remedy in its FY 2010 ACD, that remedy was affirmed on appeal, and the Postal Service has failed to follow or adequately justify its deviation.

C. Statutory Preferential Rates

39 U.S.C. 3626(a)(6) requires nonprofit rates to be set in relation to their commercial counterparts regardless of the nonprofits' independent costs. Nonprofit rates are set to yield per-piece revenues that equal, as nearly as practicable, 60 percent of commercial revenues. No commenter challenges the Postal Service's compliance with this requirement. The Commission finds that the Postal Service's planned nonprofit rates conform with this statutory preference.

[66] The Commission sets forth two examples, both of which would permit the Postal Service to comply with the FY 2010 ACD directive and the applicable price cap by making changes to only Standard Mail Flats prices and no other Standard Mail prices. For instance, the prebarcoding discount between automation and non-automation Flats could be reduced. The increase in this discount was "not a strategic move from the Postal Service, but instead an inadvertent increase" and the Postal Service notes it plans to "gradually eliminate the excess incentive." Notice at 44. Reducing it now would result in prices that comply with the directive. If the Postal Service's proposed price adjustments for the Standard Mail class minimally exceed the price cap (2.570 percent), unused rate adjustment authority from Docket No. R2008-1 (0.062 percentage points) and Docket No. R2009-2 (0.041 percentage points) could be used pursuant to 39 U.S.C. 3622(d)(2)(C)(iii). Alternatively, the Flats origin pound-rate price could be increased. Currently, the passthrough between origin and DNDC Flats is 70.6 percent and the passthrough between origin and DSCF Flats is 79.2 percent. Increasing the Flats origin pound-rate would move both passthroughs toward 100 percent and result in prices that comply with the directive. These examples are illustrative only.

The Alliance of Nonprofit Mailers (ANM) filed two replies to the Postal Service's response to CHIR No. 5. ANM's comments concern the calculation of the nonprofit commercial ratio and the differential discounts between certain commercial and nonprofit price categories.

Calculation of nonprofit commercial ratio. ANM questions the Postal Service's original calculation of the nonprofit commercial ratio.[67] The Postal Service's initial calculation did not include revenue forgone from certain promotions. *See* Response to CHIR No. 5, question 2. As ANM acknowledges, the inclusion of promotions in the nonprofit commercial ratio only changes the calculation by 0.01. However, ANM is concerned that if the Postal Service continues the practice of not including all revenue in the nonprofit commercial ratio, the difference could grow to be substantial.

Commission analysis. The Commission shares ANM's concerns and the Postal Service should file workpapers in future rate adjustments that include all revenues in its nonprofit commercial ratio calculations to better promote transparency in nonprofit rates.

Nonprofit discounts. ANM also submits comments on the subject of worksharing discounts for nonprofit Standard Mail.[68] ANM takes issue with several proposed discounts that are smaller for nonprofit than its commercial counterparts. ANM CHIR No. 5 Reply Comments at 1. It states that disparities of this kind, unless supported by a rational justification, violate 39 U.S.C. 403(c) and contravene the holding in *National Easter Seal Society v. USPS*, 656 F.2d 754 (D.C. Cir. 1981). It maintains that the Postal Service has not offered any rational justification for the disparity in discounts between commercial and nonprofit mail in the current rate proceeding other than the explanation that the disparity "protects against over 100 percent passthroughs for

[67] Reply of Alliance of Nonprofit Mailers to USPS Response to Chairman's Information Request No. 5, question 2, November 8, 2012.

[68] Reply of Alliance of Nonprofit Mailers to USPS Responses to Chairman's Information Request No. 5, questions 8-13, November 13, 2012.

Commercial and Nonprofit." *Id.* at 3. ANM asserts that this rationale is unconvincing because the Postal Service uses the same cost avoidance data as benchmarks for both commercial and nonprofit worksharing discounts, and therefore provides no basis for having different nonprofit and commercial discounts. *Id.*

Commission analysis. ANM's arguments were not provided during the initial comment period. It contends that the Postal Service failed to justify disparities between discounts offered to commercial and nonprofit users of Standard Mail and that the disparities violate section 403(c).

Upon re-filing of its Standard Mail rates, the Postal Service is requested to provide a justification as to why it views the different levels of discounts to Standard Mail consistent with the PAEA and not contrary to *National Easter Seal Society*. Alternatively, the Postal Service may also revise these discounts.

D. Worksharing Issues

The Commission is required to ensure that workshare "discounts do not exceed the cost that the Postal Service avoids as a result of workshare activity" unless the discount falls within a specified exception. 39 U.S.C. 3622(e).

Commission rules require the Postal Service to justify any proposed workshare discount that exceeds 100 percent of the avoidable costs by explaining how it meets one or more exceptions under the PAEA. The Postal Service shall also identify and explain discounts that are set substantially below avoided costs, and explain any relationship between discounts that are above and those that are below avoided costs. 39 CFR 3010.14(b)(6).

In its filing, the Postal Service identifies eleven[69] planned rate discounts within the Standard Mail class that have passthroughs exceeding 100 percent. The following passthroughs exceed 100 percent of avoidable costs:

- Mixed Network Distribution Center (NDC) Irregular Nonbarcoded Parcels to Mixed NDC Irregular Barcoded Parcels discounts 156.1 percent of the avoidable cost;
- Mixed NDC Machinable Nonbarcoded Parcels to Mixed NDC Machinable Barcoded Parcels discounts 156.1 percent of the avoidable cost;
- Mixed NDC Nonbarcoded Marketing Parcels to Mixed NDC Barcoded Marketing Parcels discounts 156.1 percent of the avoidable cost;
- Mixed NDC Irregular Parcels to NDC Irregular Parcels discounts 280.8 percent of the avoidable cost;
- NDC Irregular Parcels to Sectional Center Facility (SCF) Irregular Parcels discounts 119.1 percent of the avoidable cost;
- Mixed NDC Marketing Parcels to NDC Marketing Parcels discounts 180.0 percent of the avoidable cost;
- NDC Marketing Parcels to SCF Marketing Parcels discounts 116.9 percent of the avoidable cost;
- Non-automation Mixed ADC Flats to Automation Mixed ADC Flats discounts 326.1 percent of the avoidable cost;
- Non-automation Mixed ADC Non-machinable Letters to Non-automation ADC Non-machinable Letters discounts 120.3 percent of the avoidable cost;
- Non-automation ADC Non-machinable Letters to Non-automation 3-Digit Non-machinable Letters discounts 136.0 percent of the avoidable cost; and
- Non-automation 3-Digit Non-machinable Letters to Non-automation 5-Digit Non-machinable Letters discounts 125.0 percent of the avoidable cost.

[69] Initially, the Postal Service reported that the passthrough for Automation 3-Digit Flats was over 100 percent. In Response to CHIR No. 3, question 1 the Postal Service explained that the discount for Automation 3-Digit Flats to Automation ADC Flats is set at 100 percent, and the error was a result of the Postal Service relying on an incorrect avoided cost.

The Postal Service's stated statutory justifications for these proposed passthroughs are discussed below.

Mixed NDC irregular nonbarcoded parcels to Mixed NDC irregular barcoded parcels; Mixed NDC machinable nonbarcoded parcels to Mixed NDC machinable barcoded parcels; and Mixed NDC nonbarcoded Marketing Parcels to Mixed NDC barcoded Marketing Parcels. These passthroughs support discounts for having the mailer affix a barcode to mailpieces, eliminating the need for the Postal Service to barcode the pieces.

The Postal Service justifies these three excessive passthroughs under section 3622(e)(2)(D), as necessary to encourage mailers to develop a fully barcoded parcels mailstream. *Id.* at 48. The Postal Service states that a fully barcoded mailstream would allow the elimination of keying stations on parcel sorters and increase efficiency overall. *Id.* The Postal Service also anticipates implementing a requirement for all ground parcels to have a barcode, and states that it is inappropriate to reduce the incentive to voluntarily barcode parcel-shaped pieces. *Id.*

Mixed NDC irregular parcels to NDC irregular parcels and NDC irregular parcels to SCF irregular parcels. These passthroughs support discounts for a greater level of presort for mailpieces.

The Postal Service justifies these excess passthroughs under section 3622(e)(2)(D), as needed to ensure long-run operational efficiency in its parcel mail processing system. *Id.* at 45.

The Postal Service notes that the Commission accepted, in Docket No. R2011-2 and in the FY 2010 ACD, the Postal Service's rationale for greater than 100 percent passthroughs in these areas. *Id.* The Postal Service's rationale was that a new and improved costing model for parcel-shaped pieces "produced avoided costs that were significantly different from those estimated using the former cost model." *Id.* The Postal

Service stated that adjusting the discounts to match the new costs would be needlessly disruptive to parcel mailers, and sudden shifts in mailing patterns may cause disruption to postal operations. *Id.* at 45-46.

In this case, the Postal Service continues the trend of reducing the passthrough to better align with avoidable costs. *Id.* at 46.

Mixed NDC marketing parcels to NDC marketing parcels; and NDC marketing parcels to SCF marketing parcels. These passthroughs support discounts for greater level of presorting for mailpieces.

The Postal Service justifies the excess passthrough under section 3622(e)(2)(D) as necessary to ensure operational efficiency due to recent mail classification schedule changes. *Id.*

The Postal Service has reduced the passthroughs of both of these pairs from the last rate adjustment in Docket No. R2012-3, but urges caution in implementing more drastic changes at this time because it states that it is not clear what the final effects of the changes are on avoided costs estimates. *Id.* The avoided costs for both pairs have decreased. *Id.* While the Parcels category remains in transition, stable avoided costs estimates are not available. *Id.* at 47.

The Postal Service contends that experience with Marketing Parcels will allow it to ensure the worksharing discounts for the category ensure efficient operations. *Id.* at 43.

Non-automation Mixed ADC Non-machinable Letters to Non-automation ADC Non-machinable Letters; Non-automation ADC Non-machinable Letters to Non-automation 3-Digit Non-machinable Letters; and Non-automation 3-Digit Non-machinable Letters to Non-automation 5-Digit Non-machinable Letters. The Postal Service justifies the passthroughs for each of these discounts pursuant to 3622(e)(2)(B).

The Postal Service explains that to align each of these discounts with avoided costs would result in rate increases of 9.2 percent, 11.7 percent, and 18.1 percent, respectively. Response to CHIR No. 3, question 1. The Postal Service indicates that it will work towards aligning the discounts with avoided costs in the future. *Id.*

Non-automation Mixed ADC Flats to Automation Mixed ADC Flats. This passthrough supports a discount for having the mailer affix a barcode to mailpieces, eliminating the need for the Postal Service to barcode the pieces.

The Postal Service justifies the excess passthrough under section 3622(e)(2)(D), as aiding in the implementation of the Flats Sequencing System (FSS) program by encouraging barcoding to the maximum extent possible. Notice at 43. The Postal Service anticipates gradually phasing out the excess discount. *Id.* at 44. The Postal Service "inadvertently increased" the discount, and explains that the increase was not a strategic move. *Id.* at 44.

Commission analysis. The Commission approves all of the proposed workshare discounts in Standard Mail. The Postal Service explanations adequately describe how each of these discounts is consistent with or is justified by an exception under 39 U.S.C. 3622. *See* 39 CFR 3010.13(j).

E. Mail Classification Changes

In conjunction with its proposed price adjustment for Standard Mail, the Postal Service requests the approval of several mail classification changes.

First, the Postal Service requests the addition of six promotions that will occur at various times during calendar year (CY) 2013: (1) Mobile Coupon/Click-to-Call; (2) Earned Value Reply Mail Promotion; (3) Emerging Technologies; (4) Picture Permit Promotion; (5) Mobile Buy-It-Now Promotion; and (6) Product Samples Promotion. The first five of these promotions have been discussed in detail in section III. First-Class Mail of this Order.

The Product Samples Promotion, scheduled to be in effect from August 1, 2013 through September 30, 2013, encourages mailers to send samples via the mail by offering a 5 percent discount for Standard Mail Regular and Nonprofit Marketing Parcels. No comments were received regarding the Product Samples Promotion. The Commission approves the addition of the Product Samples Promotion. However, the Commission is concerned that the Promotion is being offered for a product that had a 79.5 percent cost coverage in FY 2011. The Postal Service has provided no discussion of whether and how the Promotion may aid Standard Mail in producing sufficient revenues to cover its attributable costs. The Commission encourages the Postal Service to monitor the impact of the Promotion on the Standard Mail Parcel cost coverage.

Second, the Postal Service proposes the addition of High Density Plus Letters and High Density Plus Flats price categories. The Postal Service originally characterized these price categories as worksharing discounts, with Carrier Route Letters and Carrier Route Flats serving as the respective benchmarks. Subsequently, in a late Response to CHIR No. 1, question 3, the Postal Service states it no longer believes these new price categories qualify as worksharing. CHIR No. 1, question 3 requested information required by the Commission when a new workshare discount is established. Based on its belief that a workshare relationship does not exist, the Postal Service did not provide the requested information.

The Commission authorizes the addition of these new price categories. Whether the new rates constitute workshare discounts under section 3622(d) is a question that must be more fully addressed and considered. The Commission will establish a separate docket to provide for public comment on and Commission consideration of whether or not these rates constitute workshare discounts.

Third, the Postal Service proposes a restructuring of the parcel rates for Carrier Route Parcels, High Density Parcels and Saturation Parcels. These changes are referred to as "Simple Samples." Notice at 25. The Postal Service proposes to eliminate all worksharing relationships and replace the previous rate structure with volume discounts and pallet and container charges. The Postal Service explains that the new discounts will benefit Consumer Packaged Goods companies and Mail Service Providers who send samples through the mail. Response to CHIR No. 4, question 2. The Postal Service proposes the new pricing structure as a way to help the product samples industry and states that it should not have a negative impact on small businesses. The Postal Service maintains that while the handling fees could be considered reverse discounts, that was not the Postal Service's intent. *Id.* question 3. The Postal Service also explains that the handling fees were developed from the transportation costs and mail processing costs associated with cross docking pallets and sorting cartons. *Id.*

The classification and rate changes proposed by the Postal Service are approved. As with High Density Plus rates, there is concern over whether the workshare discount limitations of section 3622(d) should be applied. Here too, the issue should properly be addressed and resolved in a public proceeding not subject to the time limitations of a rate request.

F. Commenter Issues

Mail Classification changes. The comments regarding promotions that were filed by the Public Representative, NPPC, Valpak, Pitney Bowes, and NAPM are discussed and addressed in the First-Class Mail section of this Order.

Standard Mail Flats. Seven parties commented on the proposed price adjustment for Standard Mail Flats and the Postal Service filed Reply Comments. This section provides a detailed discussion of these comments and the Commission's Analysis.

Worksharing. The Public Representative expresses concern that passthroughs significantly above or below 100 percent may disadvantage some groups of mailers or create substantial entry barriers to worksharing competition. PR Comments at 10. He recommends that the Commission reject discounts that disadvantage one mailer over another. *Id.*

The Public Representative enumerates several potential issues with the new High Density Plus and Simple Samples rate structures. First, he notes that the Postal Service has severed the worksharing relationship between Carrier Route Letters and High Density Saturation Letters as part of its introduction of High Density Plus Saturation Letters. *Id.* at 11.

Second, he states that the elimination of High Density Parcels with no justification enables the Postal Service to eliminate the worksharing discounts between High Density and Carrier Route Parcels. *Id.* at 12. He takes issue with elimination of pricing structures in favor of prices that are not based on Efficient Component Pricing (ECP). He requests the Commission to protect worksharing relationships based on ECP as the best method of maintaining efficient preparation practices by the mailing community. *Id.*

Finally, the Public Representative states that the pricing structure of Carrier Route Parcels is "unjustified and irrational" because its pallet handling fees do not follow worksharing relationships. *Id.* He contends that this pricing structure signals a pattern which may signal dismantling of ECP, and urges the Commission to seriously inquire into this matter and consider the issue. *Id.*

The Newspaper Association of America comments in support of the new High Density Plus pricing tiers. It is pleased that the Postal Service has incorporated this pricing tier, establishing a more user-friendly rate design. NAA Comments at 2. However, it views the level of discount as problematic, stating that the Postal Service has not priced the new tier at a discount sufficient to retain or attract volume that has moved out of the system. NAA asserts that for the new High Density Plus tier to attract significant volume, this rate will need to be substantially closer to the midpoint between High Density and Saturation rates. *Id.* at 2. It also maintains that the High Density Plus tier does not aid NAA members that may not have sufficient density in their mailings to qualify for the new tier, and urges the Postal Service to work actively to reduce the 2.7 cent difference between the High Density and Saturation tiers. *Id.* at 3.

Valpak's comments address two areas related to worksharing. First, it expresses concern that the Postal Service has set passthroughs within the Standard Mail Flats product substantially above 100 percent, while setting passthroughs for highly profitable High Density well below 100 percent. Valpak Comments at 47-48. It claims that the Postal Service "has not adequately explained why it offers discounts above cost avoided for a significantly underwater product like Standard Flats, and discounts well under cost avoided to highly profitable mail like High Density and Saturation Letters." *Id.* at 48 Second, Valpak does not believe the new High Density Plus workshare tier should be considered worksharing because it alleges that density does not meet the definition of workshare in 39 U.S.C. 3622(e). *Id.* at 49.

NAPM raises the issue of excess capacity in the system and petitions the Commission to "instruct the Postal Service to construct price signals that recognize the importance of efficiency by promoting worksharing, as opposed to making use of excess capacity." NAPM Comments at 3.

Commission analysis. As previously stated, the Commission approves all the proposed workshare discounts as consistent with the law or adequately justified. The Commission supports the reduction, over time, of those discounts with excess passthroughs. The Postal Service is also encouraged to adjust discounts with passthroughs well under 100 percent as a way of sending efficient price signals to mailers.

The Public Representative is concerned that the new pricing structure for Simple Samples sends inefficient pricing signals. There the Postal Service explains that a mailer who submits a 3-Digit Pallet must pay a pallet handling fee, as well as a carton/sack fee. A mailer who submits a 5-Digit Pallet is only required to pay a pallet fee. This pricing structure is likely to send logical price signals to mailers *i.e.*, a 5-Digit Pallet is cheaper than a 3-Digit Pallet.

Prior to the Postal Service's claim that it does not believe High Density Plus is worksharing, Valpak filed comments that High Density Plus should not be treated as a workshare discount. Valpak contends that density does not meet the definition of worksharing. *See* Valpak Comments at 49.

As discussed earlier, the Commission finds that there may be worksharing relationships present within the new pricing structures for Simple Samples and High Density Plus. The Commission has the authority to define workshare discounts pursuant to 39 U.S.C. 3622(a).[70] To further examine these new pricing structures, the Commission will establish a separate docket to provide for public comment on and Commission consideration of whether or not these rates constitute workshare discounts.

[70] That provision defines worksharing as the "presorting, prebarcoding, handling, or transportation of mail, as further defined by the Postal Regulatory Commission under subsection (a). The reference is to subsection 3622(a), the Commission's general authority to promulgate regulations necessary to establish a modern system of rate regulation.

V. PERIODICALS

A. Introduction

Products. The Periodicals class, which includes publications such as magazines and newspapers, consists of two products: Within County and Outside County. Notice at 27.

B. Price Adjustments

Postal Service's planned adjustments. The Postal Service plans to increase Within County Periodicals prices by an average 2.903 percent and Outside County Periodicals prices by an average 2.535 percent. The proposed overall average increase for the Periodicals class is 2.549 percent. Response to CHIR No. 7 at 2. This percentage increase is 0.021 percentage points less than the Postal Service's current annual limitation authority of 2.570 percent. The Postal Service does not apply any unused rate authority to the pricing of Periodicals. *Id.* Cumulative unused pricing authority for the Periodicals class following this change is -0.541 percent.

The following table summarizes the proposed average percentage price changes for Periodicals.

Table V-1

Summary of Planned Average Percentage Price Increase for Periodicals

Product	Price Changes %
Outside County	2.535
Within County	2.903
Overall	2.549
Source: CHIR No. 7	

Postal Service's position. The Postal Service characterizes the Periodicals class as "challenged in terms of cost coverage," as it did not cover its attributable costs in FY 2011 (Factor 2, Objective 8). Notice at 27. The Postal Service says it is cognizant of the special situation for Periodicals in terms of both its value to the public (Factor 8, Factor 11), and its failure to cover costs. *Id.* at 27-28. It says this price change "simply refines price relationships to encourage efficiency and containerization, while limiting the price increases for individual publications." It notes that the actual price paid by a given publication is the combination of many price elements, so care has been taken to adjust the individual price elements in a manner that limits the resulting postage increases. *Id.*

Commenters' views. Valpak observes that the Periodicals class has a history of losses, including a loss of $2.747 billion from FY 2007 to FY 2011. Valpak Comments at 4. It notes that the Postal Service has used almost all its Periodicals price cap authority, and states that "there will never be a way that PAEA cap-limited price adjustments alone will enable Periodicals to cover [attributable] costs." *Id.* at 4 n.7. No other commenter specifically addresses the planned adjustments for Periodicals.

Commission analysis. The Postal Service's planned price adjustment of 2.549 percent for the Periodicals class is 0.021 percentage points less than the current annual limitation authority; therefore, the Commission finds this adjustment in compliance with the annual price cap limitation.

C. Statutory Preferential Rates

Postal Service's position. The Periodicals class is accorded several statutory pricing preferences. The Postal Service says it implements these preferences in the same manner as in Docket No. R2012-3. Postal Service Comments at 32. It notes that the Commission's conclusion in that case was that the Postal Service's approach reflected an appropriate interpretation of 39 U.S.C. 3626. *Id.*

Within County. Section 3626(a)(3) requires that the prices for Within County Periodicals reflect this product's preferred status relative to the prices for regular rate (Outside County) Periodicals. The Postal Service says the price adjustment in this case "continues to recognize the preferential status of Within County Periodicals by setting prices below those of regular Outside County Periodicals." *Id.*

Outside County—Nonprofit and Classroom. 39 U.S.C. 3626(a)(4)(A) requires that Nonprofit and Classroom Periodicals receive, as nearly as practicable, a 5 percent discount from regular rate postage, except for advertising pounds. Consistent with past practice, the Postal Service maintains this rate preference by giving Nonprofit and Classroom pieces a 5 percent discount on all components of postage except for advertising pounds and ride- along pieces. *Id.* at 33.

Outside County—Science of Agriculture Periodicals. Section 3626(a)(5) requires that Science of Agriculture Periodicals be given preferential treatment for advertising pounds. The Postal Service says it continues to provide these publications with advertising pound rates for destination delivery unit (DDU), destination sectional center facility (DSCF), and destination area distribution center (DADC), and Zones 1 & 2 that are 75 percent of the advertising pound rates applicable to regular Outside County Periodicals. *Id.*

Limited circulation discount. Section 3626(g)(4) provides preferential treatment for the Outside County pieces of a Periodicals publication with fewer than 5,000 Outside County pieces and at least one Within County piece. The Postal Service notes that it implemented a "limited circulation" discount in 2008, which gives these mailers a discount equivalent to the Nonprofit and Classroom discount. It retains that discount in this case. *Id.* at 34.

Commenters' views. No commenter addresses the consistency of the Postal Service's Periodicals pricing plan with statutory preferences.

Commission analysis. Commission review of the Postal Service's filing confirms its consistency with statutory preferences for mail in the Periodicals class. Comparable categories of automation and non-automation Within County Flats have rates that are approximately 65 percent less than comparable Outside County Flats prices. This satisfies section 3626(a)(3). The proposed "limited circulation" discount is approximately 5 percent, in line with section 3626(g)(4). Nonprofit and Classroom publications receive a 5 percent discount from regular, Outside County piece, bundle, sack, and pallet prices, and editorial pounds consistent with 39 U.S.C. 3626(a)(4)(A). Science of Agriculture advertising pound rates are 25 percent less than regular Periodicals, thereby satisfying section 3626(a)(5). Finally, the discount for editorial pounds is between 16 and 72 percent. This exceeds the minimum 5 percent discount required under section 3626(4)(a)).

D. Worksharing

Exception to statutory requirement on avoided costs. 39 U.S.C. 3622(e) generally requires the Commission to ensure that worksharing discounts do not exceed avoided costs with certain exceptions. One exception applies when the discount is provided in connection with subclasses of mail consisting exclusively of educational, cultural, scientific, or informational (ECSI) value. 39 U.S.C. 3622(e)(2)(C). Commission rule (39 CFR 3010.14(b)(6)) requires the Postal Service to explain discounts set substantially below avoided costs.

Postal Service's position. The Postal Service presents worksharing-related data for Periodicals in Attachment B to the Notice.[71] The Outside County table shows discounts or surcharges, cost differentials, and passthroughs for presorting. *Id.* at 52. The Within County table shows the same information for presorting, prebarcoding, and dropshipping. *Id.* Another table shows bundle and container pricing. *Id.*

[71] The Commission notes that the Postal Service's presentation of worksharing-related data for periodicals facilitates the rate review process.

The Postal Service observes that "some" Periodicals passthroughs exceed 100 percent. Many apply to low volume categories, such as automation letters. *Id.* at 51. The Postal Service notes that price swings would occur if these passthroughs were changed. *Id.* at 51-52. The Postal Service states that for this price adjustment, the flexibility of the container-bundle-piece price structure is used to limit the extent to which price increases for individual publications differ from the average.

Within County passthroughs. No Within County passthrough exceeds 100 percent; one equals 100 percent.

Postal Service's position. The Postal Service does not address Within County worksharing.

Commenters' views. No commenter addressed Periodicals worksharing.

Commission analysis. The Postal Service's pricing reflects its interest in keeping price increases for individual publications close to the annual price cap limitation. The Postal Service did not provide information detailing how the planned price adjustments will impact mailers or improve pricing efficiency. Because most prices increase by the annual price cap limitation, the planned prices generally result in similar passthroughs and price/cost ratios for bundles, sacks, and pallets in the Outside County product. The Commission continues to believe that aligning prices more closely with costs would improve the Postal Service's financial situation; however, because the Periodicals class consists exclusively of mail matter with some ECSI content, the Commission finds that the worksharing discounts proposed by the Postal Service for the Periodicals class comply with statutory requirements. The following table details the distribution of passthroughs.

Table V-2

Docket No. R2013-1 Periodicals Piece Passthrough Distribution

	Number of Passthroughs	Rate Category Volume
Below 80 Percent	5	4,235,084,020
Between 80 and 120 Percent	6	1,587,588,983
Between 120 and 250 Percent	3	219,084,388
Over 250 Percent	6	83,678,627
Total	20	6,125,436,019

Source: PRC-LR-R2013-1/3

The Postal Service continues to focus on minimizing differences in price increases between publications in designing Periodicals prices. As avoided costs have changed, this has led to passthroughs diverging further from 100 percent. This is reflected in the changes to the price/cost ratios for pallets. The following table compares the price/cost ratios resulting from the Docket No. R2012-2 and the Docket No. R2013-1 Price Adjustments.

Table V-3

Periodicals Pallet, Sack, and Bundle Price/Cost Ratios

	R2012 Prices	R2013 Prices
Under 30 Percent	6	9
Between 30 and 50 Percent	34	43
Over 50 Percent	15	6

Source: PRC-LR-R2013-1/3

Since the Docket No. R2012-2 price adjustment, costs for pallets, sack and bundles have increased approximately 10 percent on average. In the planned Docket No. R2013-1 prices, the Postal Service increases prices for these three rate elements by approximately 2.5 percent. Consequently, the average price/cost ratio of these rate elements will be lower in 2013 than it was in 2012.

The proposed rates appear to be consistent with the statutory standards of 39 U.S.C. 3622.

VI. PACKAGE SERVICES

A. Introduction

The Package Services class contains five products: (1) Alaska Bypass Service; (2) Bound Printed Matter Flats (BPM Flats); (3) Bound Printed Matter Parcels (BPM Parcels); (4) Media Mail/Library Mail; and (5) Inbound Surface Parcel Post (at UPU rates).[72]

B. Price Adjustments

For Package Services, the Postal Service proposes an average price increase of 2.567 percent.[73] Based on the available inflation-based price adjustment authority, the instant proceeding creates new unused rate authority of 0.003 percent.[74] Summing the new unused rate adjustment authority with the existing rate adjustment authority produces a total unused rate adjustment authority of -0.530 percent.[75]

Table VI-1 displays the average price increase given to each product, as well as each product's FY 2011 cost coverage. The Postal Service proposes above average price increases for BPM Parcels and Media Mail/Library Mail. For all other products, the Postal Service proposes below class average price increases.

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[72] The prices for Inbound Surface Parcel Post are determined by the Universal Postal Union (UPU), not the Postal Service. Notice at 28 n.21.

[73] United States Postal Service Notice of Errata to USPS-LR-R2013-1/4, [Errata], November 8, 2012, which shows a revised average price increase of 2.567 percent.

[74] The Postal Service chose not to use any unused rate authority in this filing.

[75] The -0.530 percent in total unused rate adjustment authority is calculated by adding the 0.003 percent in new unused authority from the instant docket to the -0.533 percent in existing unused authority.

In Docket No. MC2012-13, the Commission approved the Postal Service's Request to transfer Parcel Post to the competitive product list.[76] The Postal Service proposed to leave Alaska Bypass Service on the market dominant product list as a Package Services product offering.[77] The addition of Parcel Post to the competitive product list and Alaska Bypass Service to the market dominant list will occur concurrently on January 27, 2013. The Postal Service explains that for this price adjustment, Alaska Bypass Service prices will be based on the previous 70-pound Parcel Post prices for Zones 1, 2, and 3. It clarifies that in future price adjustments, Alaska Bypass Service prices will not be based on the competitive Parcel Post product.

Table VI-1

Package Services Price Adjustment

Package Services Product	Price Change %
Alaska Bypass Service	1.890
BPM Flats	0.002
BPM Parcels	3.424
Media Mail/Library Mail	3.469
Inbound Surface Parcel Post (at UPU rates)	1.552
Source: USPS-LR-R2013-2/4, Revised November 8, 2012	

[76] Docket No. MC2012-13, Order Conditionally Granting Request to Transfer Parcel Post to the Competitive Product List, July 19, 2012 (Order No. 1411). In Docket No. CP2013-3, the Commission determined that the Postal Service satisfied the conditions of Order No. 1411. Docket No. CP2013-3, Order No. 1536, Order Approving Changes in Rates of General Applicability for Competitive Products, November 8, 2012, at 16.

[77] Alaska Bypass Service allows shippers to send shrink-wrapped pallets of goods within Alaska from designated "hub points" to designated "bush points."

Comments. No commenter opposes the planned price increases for Package Services.

The Commission finds that the price adjustments for Package Services are consistent with 39 U.S.C. 3622(d).

C. Statutory Preferential Rates

39 U.S.C. 3626(a)(7) requires that Library Mail prices be set at 95 percent of Media Mail prices. The Postal Service explains that it satisfies this requirement by setting each Library Mail price element equal to 95 percent of its corresponding Media Mail price element. Notice at 33.

The Commission finds that the prices for Media Mail and Library Mail comply with section 3626(a)(7).

D. Worksharing

39 U.S.C. 3622(e) requires the Commission to ensure workshare discounts do not exceed estimated avoided costs unless an exception applies. To determine if workshare discounts comply with section 3622(e), the Commission analyzes the passthroughs (discounts divided by cost avoidances) for each discount.

Three Package Services products offer workshare discounts: Media Mail/Library Mail, BPM Flats, and BPM Parcels.

Media Mail/Library Mail. There are four discounts offered for Media Mail/Library Mail. All workshare discounts for Media Mail/Library Mail are equal to or less than their avoided costs. *Id.* at 53.

BPM Flats and BPM Parcels. There are 15 discounts offered for BPM Flats and 12 discounts for BPM Parcels. All workshare discounts for both products are equal to or less than their avoided costs. *Id.*

The Commission finds that the workshare discounts for the Package Services class are consistent with 39 U.S.C. 3622(e).

E. Classification Changes

The Postal Service proposes classification changes for one Package Services product. No commenters oppose the classification changes.

As discussed previously, in Docket No. MC2012-13, the Commission approved the Postal Service's Request to leave Alaska Bypass Service, a former subset of Parcel Post, on the market dominant product list. The Postal Service proposes two modifications to the Alaska Bypass Service classification language approved in Docket No. MC2012-13. First, the Postal Service proposes to increase the maximum Alaska Bypass pallet weight from 2,200 lbs to 2,500 lbs. Second, the Postal Service proposes to eliminate Zone 4 through Zone 8 price categories that were available when Alaska Bypass Service was a part of Parcel Post.

The Commission approves both classification changes concerning the Alaska Bypass Service. Bypass customers will benefit from the increased maximum pallet weight. Since Alaska Bypass Service is an intra-Alaska service offering, price categories for Zone 4 through Zone 8 would be superfluous.

VII. SPECIAL SERVICES

A. Introduction

The Special Services class consists of 12 products: (1) Ancillary Services;[78] (2) Address Management Services; (3) Caller Service; (4) Change-of-Address Credit Card Authentication; (5) Confirm Service; (6) Customized Postage; (7) International Ancillary Services;[79] (8) International Business Reply Mail Service; (9) International Reply Coupon Service; (10) Money Orders; (11) Post Office Box Service; and (12) Stamp Fulfillment Services.

B. Price Adjustments

For the Special Services class, the Postal Service proposes an average price increase of 2.850 percent. Notice at 29. This is 0.280 percent over the CPI-U price cap authority. At the time of filing, the Postal Service had 2.570 percent in inflation-based price adjustment authority. The Postal Service also had 2.394 percent in unused price adjustment authority. *See* Order No. 987 at 2. Consequently, after the Postal Service implements the 2.850 percent price increase, the new total unused price authority will be 2.114 percent (0.052 percent from Docket No. R2008-1; 0.085 percent from Docket No. R2009-2; -0.577 percent by application of 39 CFR 3010.26 in Docket No. R2011-2; 0.002 percent from Docket No. R2011-2; 2.832 percent from Docket No. R2012-3; and -0.280 percent from Docket No. R2013-1).

[78] The Domestic Ancillary Services product includes 22 services: (1) Address Correction Service; (2) Applications and Mailing Permits; (3) Business Reply Mail; (4) Bulk Parcel Return Service; (5) Certified Mail; (6) Certificate of Mailing; (7) Collect on Delivery; (8) Delivery Confirmation; (9) Insurance; (10) Merchandise Return Service; (11) Parcel Airlift; (12) Registered Mail; (13) Return Receipt; (14) Return Receipt for Merchandise; (15) Restricted Delivery; (16) Shipper-Paid Forwarding; (17) Signature Confirmation; (18) Special Handling; (19) Stamped Envelopes; (20) Stamped Cards; (21) Premium Stamped Stationery; and (22) Premium Stamped Cards.

[79] The International Ancillary Services product includes 6 services: (1) International Certificate of Mailing; (2) International Registered Mail; (3) International Return Receipt; (4) International Restricted Delivery; (5) International Insurance; and (6) Customs Clearance and Delivery Fee.

The Postal Service indicates that for most Special Services products, it aimed to have fee increases close to 4.5 percent, consistent with historical rounding constraints. Notice at 30. The overall increase fell short of this target because portions of the Delivery Confirmation ancillary service were reduced to zero. *Id.* at 30 n.21.

Table VII-1 displays the average price increase proposed for each product.

Table VII-1

Special Services Price Adjustment

Special Services Product	Price Changes %
Ancillary Services	1.835
Address Management Services	5.948
Caller Service	5.876
Change-of-Address Credit Card Authentication	0.000
Confirm Service	0.000
Customized Postage	5.000
Money Orders	4.214
Other Services*	2.222
Post Office Box Service	6.002
Stamp Fulfillment Services	0.000
International Ancillary Services	11.331
International Business Reply Mail Service	16.707
International Reply Coupon Service	-100.000

*Other Services include Standard Mail Weighted Forwarding and Return. This service is not part of the Special Services MCS language. However, the service is comparable to ancillary services and is included with the Special Services class.

Source: USPS-LR-R2013-1/5.

Three Special Services do not receive price increases – Change-of-Address Credit Card Authentication, Confirm Service, and Stamp Fulfillment Services. As discussed below, the Postal Service proposes changing the name of Change-of-Address Credit Card Authentication to just Credit Card Authentication, for which it proposes to continue to impose a flat $1.00 fee. *Id.* Attachment A at 119. Confirm Service is no longer being offered.[80] Prices for Confirm Service will remain at zero as the Postal Service anticipates filing a request to eliminate Confirm Service later this year. Notice at 31. In its Notice, the Postal Service states that Stamp Fulfillment Services will not receive a price increase in recognition of the 25 to 75 percent price increase it received in last year's price adjustment. *Id.* at 30. The Postal Service is concerned that an additional price increase could provide a disincentive for customers to receive stamps by mail. *Id.*

Proposed prices for Post Office Box service increase by 6.0 percent on average. The Postal Service indicates that prices for size 1 boxes will generally not be increased, while prices for larger box sizes, which have not changed since 2009, will be increased. *Id.* at 31. Fees for all box sizes in fee group 4 will be increased. The Postal Service states that the current fees in group 4 are much lower than the fees for the next higher fee group. *Id.*

The Postal Service proposes a number of changes to fees for services that comprise the Ancillary Services product. The Postal Service proposes to increase the prices of Collect on Delivery by 9.2 percent, reflecting the value of the service and the lack of historical stability in the cost data. *Id.* at 30. To reflect the value of the services provided, the Postal Service proposes to increase Express Mail Insurance prices by 7.9 percent, to increase Return Receipt prices by 7.5 percent, and to increase Special Handling prices by 16.8 percent. *Id.* The Postal Service indicates that it is setting the

[80] In Docket No. R2012-3, the Postal Service reported that it intends to discontinue Confirm Service once existing subscriptions expire. Docket No. R2012-3, United States Postal Service Notice of Market-Dominant Price Adjustment, October 18, 2011, at 27.

prices for retail Delivery Confirmation for Package Services and Priority Mail and for electronic Delivery Confirmation for Parcel Post at zero as it continues the transition to an environment where tracking is an integral feature of parcels. *Id.* at 31. For Stamped Envelopes and Stamped Cards, the Postal Service is increasing the price of each product by one cent, resulting in price increases of 6.2 percent and 33.3 percent, respectively. *Id.* at 32. To simplify the pricing structure, the Postal Service proposes to eliminate the Periodicals Additional Entry Application fee, a fee that is part of the Applications and Mailing Permits ancillary service. *Id.* at 31.

International Reply Coupon Service has a 100 percent price decrease because the Postal Service intends to remove Outbound International Reply Coupon Service from that product. *Id.* at 55; Attachment A at 121. International Ancillary Services has an overall price increase of 11.3 percent. Based on weighted volumes, a 10.2 percent price increase in International Registered Mail, a component of this product, is largely responsible for this increase. International Business Reply Mail Services prices increase 16.7 percent. The price of International Business Reply Cards increases from $1.00 to $1.25 and the price of International Business Reply Envelopes increases from $1.50 to $1.75. Proposed prices for International Certificate of Mailing Service, which is part of the International Ancillary Services product, are set equal to the fee for the equivalent domestic service. *Id.* at 32.

Comments. No commenters commented on the proposed price changes to Special Services.

Commission analysis. The Commission finds that the planned rates for Special Services are consistent with 39 U.S.C. 3622(d).

C. Classification Changes

The Postal Service proposes classification changes for five Special Services products: (1) Address Management Services, (2) Ancillary Services, (3) Change-of-

Address Credit Card Authentication, (4) International Ancillary Services, and (5) International Reply Coupon Service. Two commenters—the Public Representative and Popkin—express concerns about some of the proposed classification changes.

Address Management Services. The Postal Service proposes to update the MCS language to add a MASS IMb Quality Testing fee of $300.00 as well as additional MASS IMb footnotes.[81] In addition, the Postal Service proposes adding Postal Explorer (CD-ROM) service to provide customers with select postal documents[82] and Change-of-Address Customer Confirmation Letter Reprint to the MCS.[83] The Postal Service proposes to eliminate the FASTforward MLOCR[84] service from the MCS because the service is no longer available. *Id.* at 55. The Residential Delivery Indicator (RDI) Service is being updated to allow copying as an additional service. *Id.* Attachment A at 111.

Ancillary Services. The Postal Service proposes to add the following ancillary services to Standard Post: Certificate of Mailing, Collect on Delivery (COD), Delivery Confirmation, Insurance, Return Receipt, Return Receipt for Merchandise, Restricted Delivery, Signature Confirmation and Special Handling. *Id.* Attachment A at 85-100. The Postal Service proposes to allow notice of attempted delivery via an electronic notice rather than "just by [a] paper notice left at the address" for Certified Mail, COD, Insurance, and Registered Mail. *Id.* at 55. The Postal Service proposes to remove two

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[81] MASS is a mail certification program.

[82] The postal documents available for the Postal Explorer (CD-ROM) include the: Domestic Mail Manual (DMM); International Mail Manual (IMM); Quick Service Guides; Domestic Price Calculator; International Price Calculator; Postal Zone Charts; Notice at 123, Price List; Customer Support Rulings; Postage Statements; Publication 28, Postal Addressing Standards, Publication 417, Nonprofit Standard Mail Eligibility and Customs Forms Indicator *http://pe.usps.com/cd_order.asp.*

[83] Change-of-Address Customer Confirmation Letter Reprint "provides customers with a copy of the letter that is sent to the customer's new address following the filing of a Change-of-Address order with the Postal Service." Notice, Attachment A at 111.

[84] MLOCR is Multi-line Optical Character Reader.

premium options—Color other than white and Monogram—from the Premium Stamped Envelopes ancillary service.

Change-of-Address Credit Card Authentication. The Postal Service proposes to rename the "Change-of-Address Credit Card Authentication" product to "Credit Card Authentication." *Id.* Attachment A at 119. The Postal Service indicates that it proposes to do this "so that it applies to all credit card authentications, rather than just those for filing Change-of-Address requests." *Id.* at 55. The proposed MCS language indicates that Credit Card Authentication will be available to verify the customer's identity and authenticate the credit card. *Id.* Attachment A at 119.

International Ancillary Services. The Postal Service proposes to eliminate Outbound International Restricted Delivery from the description of the International Restricted Delivery ancillary service while retaining Inbound International Restricted Delivery service. *Id.* at 55. It indicates that the reason for doing so is due to a steady decline in volume and revenue.

International Reply Coupon Service. The Postal Service proposes to modify the International Reply Coupon Service product by removing Outbound International Reply Coupon Service while retaining Inbound International Reply Coupon Service. *Id.* at 55. The Postal Service indicates that its reason for doing so is due to a steady decline in volume and revenue. In the FY 2011 ACD, the Commission requested that the Postal Service report on the feasibility of separately reporting costs and volumes for International Reply Coupon Service.[85] That report has not been submitted.

Comments. Two commenters—the Public Representative and Popkin–express concerns with the proposed change to the Change-of-Address Credit Card Authentication product. The current MCS language indicates that the Postal Service charges a $1.00 fee when customers use a credit card to make a change of address

[85] Docket No. ACR2011, Annual Compliance Determination Report, March 28, 2012, at 147 (FY 2011 ACD).

service request over the Internet or telephone. Notice, Attachment A at 119. The credit card information is used to verify the customer's identity to the Postal Service. *Id.* The Public Representative comments that the Postal Service has not explained whether and how often it expects to charge customers the authentication fee. PR Comments at 18. He contends that "frequent application of the fee for credit card use could impact customers' perception about the convenience and value of the Postal Service" and may have a negative impact on retail sales. *Id.* at 18-19. In his comments, Popkin seeks clarification as to whether the Postal Service intends to apply the authentication fee to routine credit card retail transactions. Popkin Comments at 2.

In a CHIR, the Postal Service was requested to identify all products and services to which the credit card authentication fee will apply. CHIR No. 6 at 1. In response, the Postal Service indicates that:

> While the Postal Service does not plan to apply the fee to any products or services in January, 2013 (other than Change-of-Address requests made online or by telephone), the Postal Service is planning later in 2013 to allow frequent customers to provide credit card information in advance for future mailings using a variety of existing products and classes of mail. The authentication fee would apply to those customers when the credit card is authenticated for future use.[86]

Popkin also comments on the proposed elimination of Outbound International Reply Coupon Service. He contends that Outbound International Reply Coupon Service provides the only practical means for amateur radio operators to exchange "QSL" cards when they make contact with other amateur radio operators throughout the world.[87] *Id.* at 1-2. He proposes that the Postal Service continue to offer outbound reply coupon service through Stamp Fulfillment Services in Kansas City. Popkin also seeks confirmation that the Postal Service will continue to redeem inbound reply

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[86] Response of United States Postal Service to Chairman's Information Request No. 6, November 6, 2012, at 2 (CHIR No. 6 Response).

[87] A QSL card is a printed or picture post card that provides written confirmation of the radio contact.

coupons. The Postal Service has not proposed to eliminate Inbound International Reply Coupon Service, which will continue to be offered.

In a CHIR, the Postal Service was requested to identify what alternatives to International Outbound Reply Coupon Service, if any, are available in *lieu* of this service. CHIR No. 6 at 1. In response, the Postal Service indicates that in some cases, money orders and online payment services may serve as alternatives to International Outbound Reply Coupons. Response to CHIR No. 6 at 2. Commenting on the Postal Service's response to CHIR No. 6 and returning to his amateur radio example, Popkin claims that payment by money order is an impractical alternative because international money orders may only be sent to 29 countries and because it would require the sender to determine the cost of postage to mail a QSL card from a foreign country to the United States.[88] Even where international money orders are available, Popkin claims that they are substantially more expensive than reply coupons.[89] With respect to online payment options, Popkin asserts that online payment would require that both parties participate in the service. *Id.* at 2.

Commission analysis. The Commission approves the proposed mail classification changes for Special Services. The proposal to remove Outbound International Reply Coupons Service is not inconsistent with the statute. The small number of consumers, such as amateur radio operators, who purchase International Outbound Reply Coupons, will no longer be able to do so. However, they will still have options. For countries to which a Money Order may be sent, once the U.S. sender ascertains (or estimates) the cost of sending the QSL card from the foreign country to the U.S., the U.S. sender can obtain and send a money order in that amount. Senders

[88] Additional Comments of David B. Popkin, November 7, 2012, at 1 (Popkin Additional Comments).

[89] The specific example that Popkin uses is Finland. In the case of Finland, a reply coupon costs $2.20. To send an International Money Order, a sender would be required to pay $4.45 for the money order, plus the additional cost for mailing a QSL card from the foreign country to the United States.

and recipients may find it more convenient and less costly to use an online payment service to transmit the cost of mailing a QSL card.

With respect to Credit Card Authentication, the Postal Service clarifies that it does not intend to impose this fee on routine retail transactions, but rather will limit it to instances in which it needs to specifically verify customer identity.

VIII. ORDERING PARAGRAPHS

It is ordered:

1. The Commission finds that the Postal Service planned price adjustments for Standard Mail Flats fail to satisfy the applicable directives for moving to remedy unlawful rates as set forth in the FY 2010 Annual Compliance Determination and further clarified and reaffirmed in Order No. 1427 and Order No. 1472.

2. The Commission remands the Standard Mail planned price adjustments identified in the United States Postal Service Notice of Market Dominant Price Adjustment, filed October 11, 2012, to allow the Postal Service to submit amendments that achieve compliance with the FY 2010 Annual Compliance Determination directives, statute, and applicable regulations.

3. In all other respects, the Commission provisionally finds that the Postal Service planned price adjustments identified in the United States Postal Service Notice of Market Dominant Price Adjustment, filed October 11, 2012, are consistent with 39 U.S.C. 3622(d), 3622(e), and 3626, and may be put into effect, as planned.

4. The Commission finds the classification changes described in the United States Postal Service Notice of Market Dominant Price Adjustment, filed October 11, 2012, are consistent with the title 39 United State Code, and may be implemented with the changes to the proposed Mail Classification Schedule language described in the body of this order. The appropriate language will be added to the draft Mail Classification Schedule.

5. Except to the extent granted or otherwise disposed of herein, all outstanding motions in this docket are denied.

By the Commission.

Shoshana M. Grove
Secretary

Commissioner Taub dissenting, in part.

DISSENT IN PART OF COMMISSIONER TAUB

I.

For the pending Docket No. R2013-1 Notice of Market Dominant Price Adjustment (Notice), I concur with the Commission's findings that the Postal Service's pricing proposals are consistent with the requirements of title 39. However, I find that the Postal Service has complied with the Commission's most recent mandates in regard to Standard Mail Flats.

In Order No. 1472, issued September 21, 2012, the Commission required, at page 3, that "the Postal Service **shall provide information** on the general remedial actions as described on pages 106-107 of the 2010 Annual Compliance Determination." (ACD) (Emphasis added). In response, in its Notice, the Postal Service provided information on the general remedial actions by explaining how it believed its proposed prices for Standard Mail Flats would capture additional revenue and contribution and move toward 100 percent cost coverage. Notice at 19-25. The Postal Service responded further in several substantive filings.

On October 18, 2012, the Commission requested from the Postal Service more detailed explanations on specific remedial actions outlined in the Commission's ACD for Fiscal Year 2010. The Postal Service provided its response on October 23, 2012, noting that although it has not given Standard Mail Flats an above-cap price increase, it believes that it will still be able to comply with the intent of the Commission's FY 2010 ACD to move Standard Mail Flats toward 100 percent cost coverage given its proposed price increases and anticipated processing savings. In this regard, the Postal Service explains that the reason it did not give Standard Mail Flats an above-average price cap increase is that it believes such an increase would impair the ability of the Postal Service to enhance its revenue/contribution under the price cap. In the Postal Service's view, this decision reflects an appropriate balance between the need to improve the cost coverage for Standard Mail Flats pursuant to the Commission's order, and the need for the Postal Service to increase contribution in order to remain economically viable.

The Postal Service further elaborated on this approach and its analysis on October 31, 2012, in response to Valpak's Motion to Strike the Standard Mail price adjustments. In addition, the Chairman issued five subsequent Chairman's Information Requests seeking clarity on how the Postal Service was calculating the rates. The Postal Service responded on October 24, 25, 26, and November 1, and 5, 2012. Most recently, in its filing in response to comments from Valpak and the Public Representative, the Postal Service explained, "it believes that the proposed prices…represent the best balance between the need to improve Flats' cost coverage and the need to protect the Postal Service's long-term contribution (and thus, financial stability). Of course, as volume trends and other factors change each year, the Postal Service will reevaluate its pricing proposals to ensure that they achieve the best balance." Reply Comments of the United States Postal Service, November 9, 2012, at 5.

As the law provides, the Commission will have the opportunity to assess the Postal Service's success in achieving this balance in future ACDs for the relevant fiscal year.

Moreover, as outlined in the second part of this dissent, the Commission clarified just three months ago in response to a remand from the United States Court of Appeals for the District of Columbia Circuit (D.C. Circuit) that substantive explanations provided by the Postal Service (along the lines of those in the pending Notice) could be considered when it undertakes the remedial actions ordered in the 2010 ACD. However, the Commission today demands formulaic adherence to the original remedy devised more than a year and a half ago. In footnote 61 of today's Order, the

Commission makes just passing reference to the most legally significant finding: "**The Commission provisionally finds that the price increases proposed for the Standard Mail class satisfy the requirements of [law].**" (Emphasis added). Yet, the Commission is sending proposed rates back to the Postal Service until they reflect a level of price increases for Standard Mail Flats satisfying to the Commission. The approach of the Commission is a step back in time toward its ratesetting role that was abolished with the former Postal Rate Commission.

Until the Postal Accountability and Enhancement Act passed in 2006, former title 39 declared that the Governors were authorized "to establish reasonable and equitable classes of mail and reasonable and equitable rates of postage and fees for postal services" (former section 3621), but this authority was severely circumscribed by the active role given the Commission. Former section 3622(a) stated that "[t]he Postal Service may submit *such suggestions for rate adjustments* as it deems suitable." After submission of suggestions by the Postal Service, the statute required the Commission to make a "recommended decision" in accordance with the policies of title 39 and specific statutory factors. With respect to each Postal Service proposal, the Commission was obliged to exercise *its* best judgment as to which among a spectrum of lawful rates or classifications was the outcome most consistent with the statutory criteria. A "recommended decision" by the Commission was recommended in name only. In almost all cases, the Commission's decision was a final determination because the statute provided little scope for change by the Governors. As the U.S. Supreme Court explained, "Although the Postal Reorganization Act divides ratemaking responsibility between two agencies, the legislative history demonstrates 'that ratemaking . . . authority [was] vested primarily in [the] Postal Rate Commission.' . . . The structure of the Act supports this view." *National Association of Greeting Card Publishers v. United States Postal Service*, 462 U.S. 810, 820 (1983) (footnotes omitted).

In contrast, in the revised statute, the authority to establish reasonable and equitable classes of mail and rates of postage is vested primarily in the Postal Service. The legislative history and structure of the act support this revised view. While the contours of a modern system of regulation must be determined by the Commission, it would be inappropriate for the Commission to assume its former role of selecting from among a spectrum of lawful rates and classifications the set of rates which is, in its judgment, most consistent with statutory criteria. In its new role of regulator rather than ratemaker, the function of the Commission is to define the spectrum of lawful rates. Within this spectrum, the Postal Service is responsible for selecting the set of rates which, in its judgment, is most consistent with its statutory mission. The Commission may *reject* a given rate or classification as unlawful, but it should no longer *recommend* rates and classifications except in the most extraordinary cases.

Unfortunately, I believe that with this Order, the Commission is at risk of regressing to its past role vis-à-vis rates for Standard Mail.

II.

Nearly 20 months ago, on March 29, 2011, the Commission issued its FY 2010 ACD, which reviewed rates and fees in effect from October 1, 2009 through September 30, 2010. In its report, the Commission concluded that the Standard Mail Flats product was not in compliance with title 39, which prompted the Commission to order certain remedial measures. Less than a month later on April 27, 2011, the Postal Service filed a petition with the D.C. Circuit seeking review of the Commission's determination of non-compliance for the Standard Mail Flats product.

While the Court was still considering the matter, nearly a year later on March 28, 2012, the Commission's FY 2011 ACD noted that shortly after the close of the fiscal year, the Postal Service had announced a planned increase for 2012 in Standard Mail Flats rates of 2.209 percent, *which was slightly above the class average.* **"Ordinarily, the Commission would consider the Postal Service's subsequent filing. Given**

the pendency of the appeal before the D.C. Circuit, however, the Commission will hold action in this area in abeyance pending receipt of the Court's decision. Following that, the Commission will take action as appropriate." (Emphasis added). FY 2011 ACD at 16.

On April 17, 2012, the D.C. Circuit found the Commission's interpretation of the law "a reasonable one" in that "the ambiguous relationship between" several statutory provisions helped "tilt the scale to the Commission" in what otherwise "seems a close call." *United States Postal Service v. Postal Regulatory Commission*, 676 F.3d 1105 (D.C. Cir. 2012) at 1108. Yet, the Court remanded the case to the Commission for a definition of the extreme circumstances that trigger application of the law (section 101(d)), and for an explanation of the appropriateness of the particular remedy imposed by the Commission.

On August 9, 2012, the Commission issued its Order on Remand, Order No. 1427, to respond to the Court's Opinion. In explaining the remedy originally ordered in March 2011, the Commission for the first time explicitly clarified that the magnitude and duration of the shortfall and subsidization required either ameliorative steps to improve cost coverage, **"or an explanation justifying the failure to take ameliorative steps."** (Emphasis added). As the Commission explained, the Postal Service had failed to attempt to do either, leading to the finding of non-compliance for fiscal year 2010. *See* Order No. 1427 at 12.

Note that the Commission in March 2011 mandated an increase in cost coverage "through a combination of above-average price adjustments, consistent with the price cap requirements, and cost reductions until such time that the revenues for this product exceed attributable costs." *Id.* at 13. In regard to this specific remedy, 17 months later, the Commission explained to the Court in the Order on Remand that its approach going forward **"...afforded the Postal Service an opportunity to tailor appropriate remedial actions under section 101(d)'s 'fair and equitable' standard to the**

specific circumstances of Standard Mail Flats." *Id.* (Emphasis added). The Court expressed concern that "the Commission's order implied that only 100% cost coverage, and nothing short of 100%, would bring Standard Flats into compliance with section 101(d)." The Commission responded that the Postal Service could be compliant at less than full cost coverage, "provided the Postal Service has either taken adequate steps toward elimination of the shortfall **or presented adequate reasons to explain the shortfall**." *Id.* (Emphasis added).

The Commission further explained: "ACDs involve a *post hoc* review of the Postal Service's prior fiscal year results, including, where relevant, remedial rate actions proposed or taken. **In the matter at hand, the Postal Service has the right to explain whether, and at what point, increased cost coverage for Standard Mail Flats might become infeasible or undesirable in light of the statutory cap and other statutory considerations. The Commission does not interpret section 101(d) to require "only 100% cost coverage, and nothing short of 100%, to satisfy the fair and equitable cost apportionment standard, provided an adequate explanation for failure to improve cost coverages is offered."** *Id.* at 14. (Emphasis added).

The Commission acknowledges in today's Order that the Postal Service's explanations are not restricted to an ACD, but are also appropriately considered when the Service proposes new rates. Therefore, the matter before the Commission is whether it finds the Postal Service's explanation sufficient, particularly in the context of the framework of current law. One year ago, in the first price change after the Commission's March 2011 ACD finding, the Postal Service proposed and then implemented an above-average increase for Standard Mail Flats. In this docket, the second proposed price change since that March 2011 ACD finding, the Postal Service seeks to raise rates for Standard Mail Flats and explains how it considers increases of a greater magnitude to be counterproductive. I find that the Postal Service has complied with the Commission's most recent mandates in regard to Standard Mail Flats for the pending Notice of Market Dominant Price Adjustment, consistent with the current statute and associated regulations for establishing postal rates.

Robert G. Taub
Commissioner

List of Commenters Addressing
Docket No. R2013-1 Notice
in response to Order No. 1501

Commenter	Abbreviation	Caption of Filing/Short Form	Filing Date
American Catalog Mailers Association	ACMA	Comments of the American Catalog Mailers Association (ACMA) (ACMA Comments)	November 1, 2012
Association for Postal Commerce	PostCom	Comments of the Association for Postal Commerce (PostCom Comments)	October 31, 2012
Greeting Card Association	GCA	Comments of the Greeting Card Association (GCA Comments)	October 31, 2012
Direct Marketing Association, Inc.	---	Joint Comments*	November 2, 2012
Mailing and Fulfillment Service Association	---	Joint Comments	November 2, 2012
National Association of Presort Mailers	NAPM	Comments of the National Association of Presort Mailers (NAPM Comments)	November 2, 2012
National Postal Policy Council	NPPC	Joint Comments	November 2, 2012
Newspaper Association of America	NAA	Comments of the Newspaper Association of America (NAA Comments)	November 1, 2012
Parcel Shippers Association	---	Joint Commenters	November 2, 2012
Pitney Bowes Inc.	PB	Comments of Pitney Bowes Inc. (Pitney Bowes Comments)	November 1, 2012
Public Representative	PR	Public Representative Comments in Response to United States Postal Service Notice of Market Dominant Price Adjustments (PR Comments)	November 1, 2012
David B. Popkin	Popkin	Comments of David B. Popkin (Popkin Comments)	October 31, 2012
		Additional Comments of David B. Popkin (Additional Popkin Comments)	November 7, 2012
Valpak Direct Marketing Systems, Inc.	Valpak	Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Comments on the United States Postal Service Notice of Market-Dominant Price Adjustment (Valpak Comments)	November 1, 2012
Valpak Dealers' Association, Inc.	Valpak	*See entry above.*	November 1, 2012

* The term "Joint Comments" is used throughout this Order to refer to the filing captioned "Joint Comments of the Direct Marketing Association, Inc., the Mailing and Fulfillment Service Association, the National Postal Policy Council, and the Parcel Shippers Association." Similarly, "Joint Commenters" refers collectively to the individual associations sponsoring the Joint Comments.

List of Chairman Information Requests,
Responses of the United States Postal Service, and Related Filings

Chairman's Information Requests

Chairman's Information Request No. 1, October 23, 2012 (CHIR No. 1)

Chairman's Information Request No. 2, October 24, 2012 (CHIR No. 2)

Chairman's Information Request No. 3, October 24, 2012 (CHIR No. 3)

Chairman's Information Request No. 4, October 25, 2012 (CHIR No. 4)

Chairman's Information Request No. 5, October 31, 2012 (CHIR No. 5)

Chairman's Information Request No. 6, November 2, 2012 (CHIR No. 6)

Chairman's Information Request No. 7, November 5, 2012 (CHIR No. 7)

Responses to Chairman's Information Requests

Response of United States Postal Service to Chairman's Information Request No. 1 [Questions 1-4 and 6-20], October 26, 2012
(Response to CHIR No. 1, Questions 1-4 and 6-20)

Response of United States Postal Service to Chairman's Information Request No. 2, October 26, 2012 (Response to CHIR No. 2)

Response of United States Postal Service to Chairman's Information Request No. 3 November 1, 2012 (Response to CHIR No. 3)

Response of United States Postal Service to Question 5 of Chairman's Information Request No. 1, November 8, 2012
(Response to CHIR No. 1, Question 5)

Response of United States Postal Service to Chairman's Information Request No. 4, November 1, 2012 (Response to CHIR No. 4)

Response of United States Postal Service to Questions 6 and 8-13 of Chairman's Information Request No. 5, November 5, 2012
(Response to CHIR No. 5, 6, 8-13)

Response of United States Postal Service to Questions 1-5 and 7 of Chairman's Information Request No. 5, November 6, 2012
(Response to CHIR No. 5, Questions 1-5 and 7)

Response of United States Postal Service to Chairman's Information Request No. 6, November 6, 2012 (Response to CHIR No. 6)

Response of United States Postal Service to Chairman's Information Request No. 7, November 7, 2012 (Response to CHIR No. 7)

Replies to Postal Service Response

Reply of Alliance of Nonprofit Mailers to USPS Response to Chairman's Information Request No. 5, Question 2, November 8, 2012

Reply of Alliance of Nonprofit Mailers to USPS Responses to Chairman's Information Request No. 5, Questions 8-13, November 13, 2012

Motions for Late Acceptance of Responses[1]

Motion for Late Acceptance of Response of United States Postal Service to Question 5 of Chairman's Information Request No. 1, November 8, 2012
(Postal Service Motion for Late Acceptance, CHIR No. 1,Question 5)

Motion for Late Acceptance of Response of United States Postal Service to Chairman's Information Request No. 3, November 1, 2012
(Postal Service Motion for Late Acceptance, CHIR No. 3)

Motion for Late Acceptance of Response of United States Postal Service to Chairman's Information Request No. 4, November 1, 2012
(Postal Service Motion for Late Acceptance, CHIR No. 4)

Motion for Late Acceptance of Response of United States Postal Service to Chairman's Information Request No. 5, Questions 1–5 and 7, November 6, 2012
(Postal Service Motion for Late Acceptance, CHIR No. 5, Questions 1–5 and 7)

Motion for Late Acceptance of Response of United States Postal Service to Chairman's Information Request No. 5 [Questions 6 and 8–13], November 5, 2012
(Postal Service Motion for Late Acceptance, CHIR No. 5 [Questions 6 and 8–13]

[1] Each of these motions is granted.

List of Errata to Postal Service Filing

Errata to Notice (listed chronologically)

United States Postal Service Notice of Errata to Notice of Market-Dominant Price Adjustment, October 19, 2012

United States Postal Service Notice of Errata to Notice of Market-Dominant Price Adjustment, November 8, 2012

Correct Attachment A Pages for United States Postal Service Notice of Errata to Notice of Market-Dominant Price Adjustment [ERRATA], November 9, 2012

Errata to Library References (listed chronologically)

United States Postal Service Notice of Errata to USPS-LR-R2013-1/4, October 19, 2012

United States Postal Service Notice of Errata to USPS-LR-R2013-1/1, November 8, 2012

United States Postal Service Notice of Errata to USPS-LR-R2013-1/4 [Errata], November 8, 2012

United States Postal Service Notice of Errata to USPS-LR--R2013-1/2 [Errata], November 9, 2012

United States Postal Service Notice of Errata to USPS-LR-R2013-1/3 [Errata], November 9, 2012

United States Postal Service Notice of Errata to USPS-LR-R2013-1/5, November 9, 2012

Number of Postal Employees Since 1926

(totals are unavailable for prior years)

Year	Number of Employees
1926	245,769
1927	248,587
1928	250,759
1929	253,147
1930	**254,563**
1931	253,433
1932	250,005
1933	242,501
1934	237,461
1935	236,472
1936	249,882
1937	253,915
1938	258,089
1939	260,800
1940	**266,076**
1941	273,418
1942	278,569
1943	268,219
1944	272,328
1945	278,442
1946	293,957
1947	301,158
1948	330,602
1949	351,974
1950	**363,774**
1951	352,017
1952	355,143
1953	360,819
1954	360,863
1955	366,901
1956	373,383
1957	379,721
1958	392,599
1959	402,776
1960	**408,987**
1961	423,739
1962	435,196
1963	437,127
1964	440,759
1965	447,394
1966	474,403
1967	509,145
1968	532,301
1969	546,181
1970	**548,572**
1971	545,911
1972	570,688
1973	548,876
1974	564,015
1975	559,064
1976	542,604
1977	528,556
1978	526,115
1979	533,749
1980	**536,373**
1981	546,154
1982	546,417
1983	546,941
1984	672,849
1985	704,807
1986	744,929
1987	765,338
1988	779,083
1989	777,715
1990	**760,668**
1991	748,961
1992	725,290
1993	691,723
1994	728,944
1995	753,384
1996	760,966
1997	765,174
1998	792,041
1999	797,795
2000	**787,538**
2001	775,903
2002	752,949
2003	729,035
2004	707,485
2005	704,716
2006	696,138
2007	684,762
2008	663,238
2009	623,128
2010	**583,908**
2011	557,251
2012	528,458

Note:
Figures are those listed in the *Annual Report of the Postmaster General* for total "regular" (through 1971), "full-time" (1972 through 1983), and "career" (since 1984) employees. Numbers for some years were revised in later years; the most recent figures are shown.

HISTORIAN
UNITED STATES POSTAL SERVICE
DECEMBER 2012

SENATE HOMELAND SECURITY AND GOVERMENTAL AFFAIRS COMMITTEE
"Outside the Box: Reforming and Renewing the Postal Service,
Part I – Maintaining Services, Reducing Costs and Increasing Revenue Through Innovation and Modernization"
September 19, 2013

Post-Hearing Questions for the Record
Submitted to the Honorable Patrick Donahoe

From Chairman Thomas R. Carper:

1. Last year, the Postal Service announced a two-phase process to both revise its delivery service standards and close a number of its processing facilities. In the first phase, which has now been implemented, the Postal Service modified its overnight delivery standard to restrict the geographical areas in which it would commit to deliver first class mail overnight; at the same time, the Postal Service has closed or is in the process of closing approximately 150 processing facilities. At the hearing, there was a discussion about what effects these changes have had on actual delivery times, particularly in rural areas. Among other things, the discussion suggested that there may be different understandings of what "delivery time" means.
   a) How are delivery times measured for purposes of determining compliance with delivery service standards? At what point is mail considered to have entered the mail stream for the purposes of calculating delivery time? For an individual piece of first-class mail without a bar code, how is the time of that point of entry determined?

      Answer:

      Mail that is received by the Postal Service prior to the Critical Entry Time (CET) on a given day is considered received on that day for purposes of calculating service standards. Delivery time is the number of calendar days from mail received prior to the Critical Entry Time to the date it is delivered, not including Sundays and Holidays. The number of days to delivery is compared to the number of days in the service standard to determine on-time performance.

      For approximately 25 years, the Postal Service has measured service performance for single-piece First-Class Mail through the External First-Class (EXFC) measurement system, which is independently operated by IBM, (formerly PriceWaterhouse Coopers). It should be noted that, in accordance with 39 U.S.C. § 3691, the Postal Service consulted with the Postal Regulatory Commission (PRC) on the requirements for the current EXFC system, and the rules for determining how to measure and report service performance. EXFC service performance data for single-piece First-Class Mail for each postal district are reported to the Commission and published on a quarterly basis. For the reasons explained below, the EXFC system provides a very reliable representation of end-to-end service for single-piece First-Class Mail.

Acting at the direction of IBM, agents who are anonymous to the Postal Service create test mailpieces and either drop them in blue collection boxes, Post Office lobby mail chutes, or hand them to postal employees at our retail service windows for processing and delivery to recipients around the nation. The test pieces are designed to be indistinguishable from other letters and flats accepted and delivered by the Postal Service. IBM also employs persons whose identities are unknown to the Postal Service to serve as the mailpiece recipients. IBM senders and recipients are located in all 50 states and territories and in every 3-digit ZIP Code area in the postal system, in urban, suburban and rural locations. Accordingly, the EXFC system generates data that can be useful in diagnosing service performance and operational issues throughout the network.

Test mail senders report their activity to IBM by indicating the date, time and locations at which they drop letters and flats into the system. Recipients identify the test mail pieces they receive and report the delivery dates to IBM, which then combines the information from senders and recipients to determine the dates of entry and delivery for each piece.

Approximately 3.1 million EXFC test mailpieces are sent annually, allowing IBM to project estimates of the volume of single-piece First-Class Mail delivered on time to and from each of the 67 districts in the postal network at a precision of +/- one percent or better at a 95 percent confidence level.

For instance, if the final collection time on a collection box is 5:00 p.m. Monday, and a test mailpiece is recorded by IBM as having been deposited in that collection box at 4:30 p.m. that day, the piece is deemed to have been mailed on Monday because it was deposited before the 5:00pm CET.

If the recipient reports the piece as having arrived on Wednesday, then IBM compares that transit time to the service standard applicable to the mail piece based on its 3-digit ZIP Code of origin and destination. If the service standard from origin to destination is two days, then the test piece is reported to have been delivered on time. On the other hand, if the applicable service standard is overnight, then the test piece is recorded as having been delivered one day late.

Assume a second hypothetical: a mail piece is dropped in the same collection box on Saturday at 11:00 a.m., an hour before the final 12 noon collection time that day. The piece will be recorded by IBM as having been mailed on Saturday since it was dropped before the Saturday CET. Assume further that there is no collection scheduled between noon Saturday and 5:00 p.m. Monday. If the Postal Service were somehow to miss collecting from that box on Saturday and did not sweep it until Monday at 5:00 p.m., for purposes of service measurement under

EXFC rules, IBM would count the intervening days against the Postal Service when determining the number of days between entry and delivery.

For EXFC purposes, the CET is based on whatever date/time applies to the collection box or retail window where the test piece is dropped. While IBM records the day and time that its agents drop specific test mail pieces in collection boxes and at retail windows, there is generally no other method for determining whether a piece picked up from a collection box on Monday at 5:00 p.m. was actually deposited there at 4:59 p.m. that day or an hour after the CET on the previous collection day (which could be Friday or Saturday, depending on the box). All pieces collected from the box at the Monday CET are deemed to have been entered on that day. Under those limited circumstances, as has always been the case, it is possible for a piece to sit in a box for a few days before the clock starts for purposes of service measurement.

b) It appears that the delivery time experienced by an individual mailing a letter may differ from the delivery time reported for purposes of determining compliance with delivery service standards. For instance, when an individual gives a letter over to the Postal Service – such as by depositing the letter in a blue collection box or dropping it at the local post office or having it picked up by a letter carrier from a residential mailbox – may not be when the clock starts running for purposes of determining compliance with delivery service standards.

Answer:

See explanation to question 1a.

i) Assuming this is correct, what, if anything, is the Postal Service doing, or does the Postal Service plan to do, to assess the end-to-end delivery times experienced by customers, including in rural areas – *i.e.*, the delivery time from when a piece of mail is transferred from the individual's possession into that of the Postal Service to when it arrives at the recipient's address – as distinct from the official delivery times used for determining compliance with delivery service standards?

Answer:

See explanation to question 1a.

ii) What, if anything, has the Postal Service done, or does it plan to do, to assess the impact that recent changes in delivery service standards, local changes in critical entry times and reductions in the number of processing plants have had on the delivery times experienced by customers, including in rural areas. Does the Postal Service intend to put in place measures to enable it to better assess the impact of future changes in the number of plants, delivery service standards or critical entry times on delivery times actually experienced by customers?

Answer:

The Postal Service has numerous processes in place to ensure that on-time service performance is not negatively impacted as a result of processing plant consolidations and/or changes in Critical Entry Times (CET). We implemented an Early Warning System (EWS) which allowed customers an easy and convenient system to enter service issues arising following consolidation. We deploy Tiger Teams to assist consolidation site locations experiencing a decline in service performance after a consolidation takes place. Additionally, we engage in multiple customer outreach efforts—including Area Focus Groups and local Postal Customer Councils (PCC)—to identify and address local service issues.

c) There are private companies that use information from the bar codes on commercial and bulk mail to track mail from end-to-end for their corporate mailer clients; I understand that some of these companies may provide some of their data analysis to the Postal Service as well. Does the Postal Service also use bar code data to track mail from an earlier point in the mail's journey than would otherwise be captured by delivery service standard compliance measures? What conclusions has the Postal Service been able to draw from its own or others' analyses of bar code data about true end-to-end delivery times, including how these times have been affected by changes in delivery standards, plant closings and changes in critical entry times, both in general and in rural areas in particular?

Answer:

The Postal Service does not have valid information about mail while it is not in its possession. Once the Postal Service takes possession of the mail, the clock starts based on whether the mail met the Critical Entry Time (CET) for that day or not. The metrics provided in service performance reports represent the end-to-end delivery times as measured against the service standard. In addition to the end-to-end delivery times, the Postal Service analyzes the data in many ways to measure service performance at many different levels beyond those required for compliance reporting. For example, barcode scan data are analyzed to examine the time between acceptance and first processing to determine cycle time. This analysis has helped improve process resulting in improved service. All of the available data is used to identify potential service problems and diagnose root cause. The Postal Service also uses the information available to identify "at risk" mail and provide alerts to employees to try to avoid delays when possible.

From Ranking Member Tom A. Coburn:

1. The IG testimony notes the diminished value of the mail monopoly, the alternatives customers have, and states that "Recent volume losses combined with the price cap imperil the Postal Service's ability to provide universal while remaining self-funded." It seems from this perspective that pricing is one of your key responsibilities and critical to the Postal Service's success.

    a. From this standpoint, who should directly control your prices? You and your Board, or the PRC?

    Answer:

    The Postal Service is in the best position to set prices consistent with market conditions. Since numerous competitive alternatives exist to the use of the mail, the Postal Service has a very strong incentive to set prices that encourage revenue and volume growth. The regulatory structure over prices and products should be streamlined to allow the Postal Service to quickly respond to the marketplace and innovate.

    b. Do you, as the Postmaster General, have a vote when it comes to pricing decisions?

    Answer:

    Under current law, the Postmaster General does not have a vote when it comes to pricing matters; those decisions are reserved to the Presidentially-appointed Governors, with final decision by the Postal Regulatory Commission (PRC).

2. Under S. 1486, do you believe there would still be sufficient protection under law for those that worry the U.S. Postal Service would abuse its position? Please explain.

    Answer:

    Yes, for the reasons discussed in the response to Question 1. Furthermore, under the bill as introduced, the Commission would still exist to adjudicate any claims that the Postal Service has abused its authority under the law.

3. Some have worried if Congress eliminates the price cap you that future postmasters general will simply raise rates instead of cutting costs. Can you respond to this concern?

Answer:

Prior to the (FY2007) price cap, the Postal Service generally maintained unit costs and Postal rates at or below inflation. As shown below, between FY1972, when the Postal Service was first established by the Postal Reorganization Act, through FY2006, when the Market Dominant mail price cap was first established, unit Postal costs increased by 207 percent while inflation increased by 382 percent.

Fiscal Year	Revenue*	Expense*	Volume*	Revenue Per Unit	Expense Per Unit	CPI-U Index
1972	$ 9,417	$ 9,592	87,156	$ 0.108	$ 0.110	42.1
2006	$ 72,817	$ 71,917	213,138	$ 0.342	$ 0.337	202.9
Total % Change				216%	207%	382%
Avg. Annual % Change				3.44%	3.35%	4.73%

*in Millions

During this same period, the price of the single-piece First-Class Mail stamp increased from 8 cents to 39 cents, or 388 percent, which is about the same as the rate of inflation. Further, the Postal Service recognizes that when mailers perform workshare activities such as presorting mail, they reduce the Postal Service's operating costs. Nearly all of the savings on presort First-Class Mail have been passed through to the mailers, resulting in those mailers paying as little as $0.29 per piece for First-Class Mail letters—a price increase of only 263 percent since 1972.

In the absence of extraordinary circumstances, there is no reason to believe that the Postal Service would not effectively manage the costs that it has full control over in a responsible manner—including improving efficiencies and cutting costs whenever possible, while maintaining service at high levels. In recent years, the Postal Service has made a particularly strong effort to reduce costs in response to changes in the marketplace. Since 2000, we have reduced 516 million workhours, or 31.7 percent, worth almost $22 billion in annual savings. The major impediments to further cost reductions in response to changes in mail volume are restrictions on our ability to manage all the costs of our business, including healthcare, delivery frequency, and FERS retirement overfunding.

Furthermore, there are numerous oversight bodies that will not allow Postal Service management to ignore cost containment. Those include the Congress, the Postal Service's Board of Governors, the Office of Inspector General and the Government Accountability Office. In addition, we ultimately are responsible to business and the mailing public, who will find alternative communications outlets if our prices are not contained. Increasing prices too high would have an adverse effect on volume and therefore has been and will continue to be a factor used in pricing decisions.

4. What steps did the Postal Service take prior to the existence of a cap to cut costs? How many years out of the history of the Postal Service has there been a cap?

Answer:

Historically, and prior to the cap, mail volume—in particular, First-Class Mail, which provided the lion's share of contribution to profit— was growing. During this period the Postal Service controlled costs largely through investments in automation and mechanization, which improved productivity. Cost savings investments were made in mail sorting machines (e.g. automated flat sorting machines, delivery bar code sorters, etc.) and mail address/barcode reading equipment (e.g. optical character readers, advance facer canceler, etc.). At the same time, the Postal Service engaged mailers in workshare initiatives (carrier route presort, drop ship, etc.), which allowed mailers to do part of the work when it was cost effective for them and further reduced costs to the Postal Service.

These productivity-improving efforts were particularly effective because mail volume was growing. Declining mail volumes have resulted in over-capacity in many of our mail processing facilities. Consolidating mail processing facilities allows us to take advantage of economies of scale while reducing costs by retiring equipment that has or is close to reaching its end of life. Current efficiency enhancing efforts include resizing the workforce and infrastructure, including plants and post offices, to better match current and forecast volume and workload levels.

The price cap took effect in December 2007, following the expiration of the period following passage of the Postal Accountability and Enhancement Act in which the Postal Service had the option to file one last rate case under the prior ratemaking rules. The Postal Service filed its first price cap-based rate increase in February 2008, and implemented that increase in May 2008.

5. The bill requires you to delay plant closures and delivery schedule changes for two years and the move to five-day delivery for one year. Does this create pressure to raise rates, at least temporarily?

Answer:

Delaying plant closures and delivery schedule changes results in a comparable delay in urgently needed cost reductions. Therefore, in the absence of offsetting legislation to improve the Postal Services' liquidity, such delays would create pressure to raise Postal rates.

6. Given current liquidity projections, please explain your views on how important it is for Congress to give you the authority to move to Modified Saturday delivery as soon as possible?

   Answer:

   It is very important for the Congress to give the Postal Service authority to move to Modified Saturday delivery.

   The Postal Service has a Five Year Business plan to return to financial stability. That Plan outlines operational and legislative initiatives, including Modified Saturday delivery. The Plan is very challenging and the Postal Service does not believe that the Plan can be achieved unless each and every initiative is fully implemented.

From Senator Carl Levin:

Closure and Consolidation of Mail Processing Facilities

1. What is the current status of facility closures and consolidations in Michigan?

   Answer:

   The chart below shows the current status of mail processing facility closures and consolidations in the state of Michigan.

STATUS OF MAIL PROCESSING FACILITY CONSOLIDATIONS - MICHIGAN

Study Facility			Gaining Facility			Consolidation Date			Current Status (Oct. 2013)
Facility	City	State	Gaining Site	City	State	Orig.	Dest.	DPS	As of November 2013
Detroit P1 Annex	Romulus	MI	Detroit P&DC	Detroit	MI	2012	2012	n/a	Closed
Gaylord P&DF	Gaylord	MI	Traverse City P&DF	Traverse City	MI	2012	2013	2013	Mail processing operations removed, post office and hub remain
Jackson MI CSMPC	Jackson	MI	Detroit P&DC Michigan Metroplex MI P&DC	Detroit Pontiac	MI MI	2012	2013	2013	Mail processing operations removed, post office and hub remain
Saginaw P&DC	Saginaw	MI	Michigan Metroplex MI P&DC	Pontiac	MI	2012	2013	2014	DPS processing remains, consolidation planned for 2014 dependent on service standard change
Wheeler Street MI Annex	Saginaw	MI	Michigan Metroplex MI P&DC	Pontiac	MI	n/a	n/a	2013	Closed
Kalamazoo P&DC	Kalamazoo	MI	Grand Rapids P&DC	Grand Rapids	MI	2012	2014	2014	Destinating processing remains, planned for 2014*
Iron Mountain P&DF	Kingsford	MI	Green Bay P&DC	Green Bay	WI	2014	2014	2014	Planned for 2014 dependent on service standard change
Lansing P&DC	Lansing	MI	Grand Rapids P&DC	Grand Rapids	MI	2013	2014	2014	Destinating processing remains, planned for 2014*

*Note:
Kalamazoo and Lansing could be consolidated without a service standard change from time/distance concern. Limitation is capacity in Grand Rapids.

2. Have the actual costs and savings of this process met the Area Mail Processing Studies criteria for closure and consolidation?

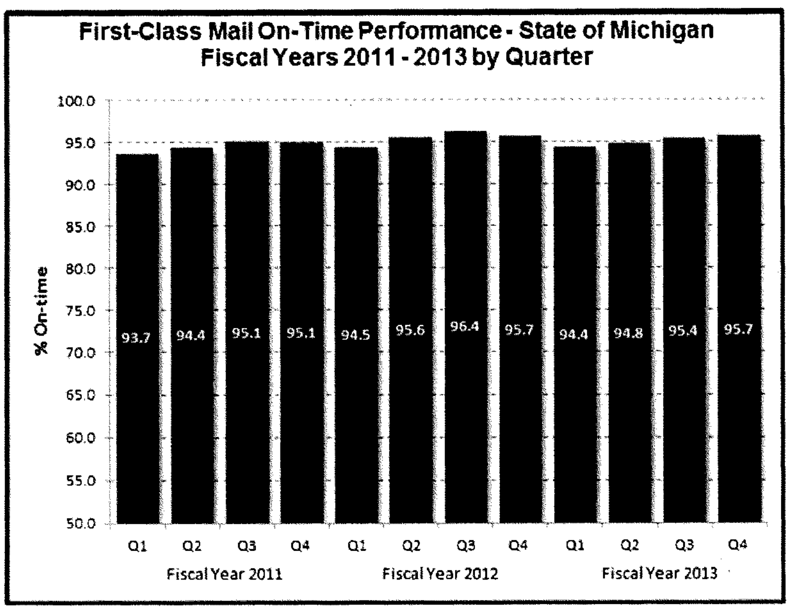
   Answer:

   The Post Implementation Review process has not been completed yet on the Michigan consolidations shown above. However, the Postal Service has completed the first round of Post Implementation Reviews on the completed Phase One consolidations from the summer of 2012. These reviews show the Postal Service has saved an additional 76 percent above the anticipated value of the 24 completed Phase One consolidations.

3. What impacts have these closures and consolidations had on delivery? Please share data on mail delivery standards and delivery performance in Michigan before and after these closures and consolidations.

   Answer:

   Ensuring that quality, predictable on-time service performance is maintained is a critical part of our Network Rationalization process. The chart below depicts First-Class Mail on-time service performance as measured by the External First-Class Measurement System (EXFC) for the state of Michigan from Quarter 1, FY 2011 through Quarter 4, FY 2013.



In February 2013, there was an inquiry raised by Gannett Publications regarding the timeline for moving entry of mailings from the closing facility to the gaining facility. In the interest to align mail entry with the physical processing of mail, the facilities advanced moving the customers' entry point to maintain service. However, the timeline established by local personnel did not coincide with national policy. Postal Headquarters, working with local leadership, met with principles at Gannett Publications to meet the customers' needs for entry in the respective facilities (Michigan Metroplex, Grand Rapids, Lansing, Kalamazoo, Gaylord and Saginaw).

Aside from the Gannett Publication inquiry, there have been no service related issues recorded through the CustomerFirst! application on network consolidations or closures in Michigan. The CustomerFirst! application is customer relationship management system for the Postal Services largest commercial customers, which provides an early warning of customers concerns. At the onset of consolidations the application was modified to specifically capture issues relative to network changes.

Last Mile Delivery

- How does USPS determine the price charged to FedEx & UPS for the Parcel Select program?

  Answer:

  The price is determined through negotiations with both FedEx and UPS within the limits established by the PAEA. Each Negotiated Service Agreement (NSA) contract is reviewed by the Postal Regulatory Commission prior to implementation.

- Under current law, the USPS must recover its cost for Negotiated Service Agreements such as the Parcel Select program, does the USPS attempt to negotiate a higher rate than just cost? Does it make a profit? If not, why not?

  Answer:

  Yes. The Postal Service seeks to negotiate the highest price above cost, balanced with the ability to win business in the marketplace. Each Negotiated Service Agreement (NSA) contract is reviewed by the Postal Regulatory Commission prior to implementation.

- Has USPS studied the price elasticity for its competitive products such as parcel delivery? If so, please provide copies of any written analysis or studies to the committee.

  Answer:

  Yes, the Postal Service has studied the price elasticity of our competitive products. The requested information is commercially sensitive and public disclosure could place the Postal Service in a competitive disadvantage in the marketplace. The Postal Service will, however, work with the committee to make this information available to members on a confidential basis.

- Has USPS considered whether the discounts granted to FedEx and UPS have impacted its ability to compete directly for the customers who chose FedEx and UPS for Parcel delivery? If so, please provide copies of any written analysis or studies to the committee.

  Answer:

  The discounts provided allow us to gain revenue from a portion of FedEx and UPS's end to end volume that we previously did not receive. Mailers choose shippers for a variety of reasons only one of which is price. Historically, this has been volume we have been unable to "win". There are no available studies or written analyses.

- How much money does the USPS receive from UPS and FedEx each year for the parcel select program for each of the past 3 years?

  Answer:

  The requested information is commercially sensitive and public disclosure could place the Postal Service in a competitive disadvantage in the marketplace. The Postal Service will, however, work with the committee to make this information available to members on a confidential basis.

- How much money does the USPS receive from UPS and FedEx for all services annually for each of the past 3 years?

  Answer:

  The requested information is commercially sensitive and public disclosure could place the Postal Service in a competitive disadvantage in the marketplace. The Postal Service will, however, work with the committee to make this information available to members on a confidential basis.

- Do you know what the average cost is to FedEx and UPS to deliver a parcel for the last mile?

  Answer:

  Such information is proprietary for FedEx and UPS and is not published. However, we estimate that their last-mile cost per parcel ranges between $1.50 and $2.50. The variance is due to differences in package size/weight and delivery address type, (rural/urban/commercial).

- How does this average compare to what the USPS charges to FedEx and UPS?

  Answer:

  The Postal Service has carefully derived the prices that it charges to FedEx and UPS. However, we can only presume that FedEx's and UPS's costs exceed our charges for those deliveries and those ZIP Codes where FedEx and UPS discretionarily choose to use us for "last-mile" service.

Transportation of US Mail on the FedEx Network

1. Is there any requirement in law prohibiting the USPS from paying more than the cost of transportation and a limited profit for services such as the transport of US Mail on private transportation networks?

   Answer:

   The provisions of law that govern the transportation of mail are found in Title V of title 39, United States Code. There are specific provisions concerning the rates that the Postal Service pays to air carriers for the transport of mail internationally or within the state of Alaska. 39 U.S.C. § 5402. Beyond these specific circumstances, the Postal Service has the general authority to "determine rates and contract with any air carrier for the transportation of mail by aircraft in interstate air transportation either through negotiations or competitive bidding." *Id.* § 5402(e)(1). *See also id.* §§ 5001, 5401.

   Based on its authority, the Postal Service entered into a contract with FedEx to provide domestic air transportation service for Priority Mail and Priority Mail Express. The award of that contract followed a competitive procurement process in which it was determined that FedEx's proposal provided the best value to the Postal Service.

2. Do you know what the costs are to FedEx & UPS to transport US Mail by air on their network?

Answer:

The Postal Service does not know what the costs are to FedEx & UPS to provide Air Transportation services, as our contracts with them are not structured as cost-reimbursement type contracts.

3. How much does the USPS pay to FedEx & UPS for the transport of US Mail by air?

   Answer:

   The requested information is commercially sensitive and public disclosure could place the Postal Service in a competitive disadvantage in the marketplace. The Postal Service will, however, work with the committee to make this information available to members on a confidential basis.

4. How much has the USPS paid to FedEx for all services for each of the past 3 years?

   Answer:

   The requested information is commercially sensitive and public disclosure could place the Postal Service in a competitive disadvantage in the marketplace. The Postal Service will, however, work with the committee to make this information available to members on a confidential basis.

5. Does FedEx & UPS make a profit on USPS?

   Answer:

   The Postal Service expects that FedEx & UPS, similar to other suppliers, garner a profit for the services rendered.

Post Offices

1. Under the Post Plan, the Postal Service is looking to reduce the hours of nearly 13,000 post offices nationwide. Concurrent with this reduction in service, the Postal Service is looking to open Village Post Offices. These Village Post Offices would be located in existing businesses and run under private contract with these businesses. Do you expect a further reduction in volume at Post Offices located near Village Post Offices?

   Answer:

   We do not anticipate a reduction in volume because the Post Office is still handling the volume, via Post Office box Service. Village Post Offices were established for the community as a retail outlet and would therefore not impact volume.

2. If so, do you anticipate either further reducing the hours of the affected Post Offices or eventually closing them if volumes continue to decline?

   Answer:

   Post Plan was a way to preserve Post Offices within the community and we will continue to review workload on an annual basis and adjusted accordingly both upward and downward.

From Senator John McCain:

1. Given the fact that the Postal Service needs to continue to right-size its mail processing networks due to the decline in mail volume, are you concerned with the 2-year moratorium this bill would put in place on mail processing plant consolidations and closures?

   Answer:

   Yes. Reducing our network costs is a critical component of restoring our financial solvency. We need a cost-effective network that is able to quickly adjust to a changing workload and mail mix. A two year moratorium on consolidations would limit our flexibility to adjust.

From Senator Claire McCaskill:

1. When a previous survey the USPS conducted to solicit input from people in rural areas on moving to 5-day delivery, the survey looked at areas outside Atlanta and Seattle

   Have there been any updated surveys done since then in more rural areas? If so, could you share those surveys and where they were taken with the Committee?

   Answer:

   Yes, two additional surveys on 5-day delivery have been conducted since the Atlanta/Seattle research. Both were completed in 2013.

   The first was conducted by IPSOS in February 2013 using a nationally representative sample of 1,002. The second survey was conducted by McKinsey in July 2013 with a nationally representative sample of 1,012. Both surveys allowed us to test the impact on 5-day delivery by urban, suburban and rural. Both of the surveys found that there is not much of a difference on the impact between rural, urban and suburban populations on moving from 6- to 5-day delivery. Rural respondents in the McKinsey study are just as likely to report that this would have either no effect or 'an inconvenience that I could adapt to relatively easily" as the total population (both at 78 percent). When asked a slightly differently manner in the IPSOS study, we found that rural residents would be less impacted than the rest of the population (71 percent – 68 percent, responded "not very much" or "not at all").

2. During the hearing, I questioned whether the USPS was maximizing its monopoly on rural delivery with respect to its competitors, UPS and FedEx. Specifically, I asked whether the USPS modeled out what would happen if the USPS decided not to carry their packages. While you claimed that the USPS did cost out the Parcel Select pricing, and the USPS does make money on its Parcel Select business as a general matter, my question was getting at the issue of whether the USPS is maximizing these returns specifically on its contracts with its competitors.

   Your response was telling, stating that the USPS had not done the study that you suggested, and "I'm sure they [UPS and FedEx] have done that, and they make the decisions using us based on what their prices are." In other words, it is your assumption that, in negotiating the prices for UPS's and FedEx's Negotiated Service Agreements (NSAs), those companies have far greater information than the USPS as to the price at which it is still profitable for them to rely on the USPS for last mile delivery.

   Please submit to the Committee the Negotiated Service Agreements that the USPS has with FedEx, UPS and other private mail carriers to provide Parcel Select service to those carriers.

   Answer:

   FedEx and UPS have more information about the price at which it is still profitable for them to rely on the Postal Service for last-mile delivery. However, the Postal Service has more information about the price at which it is still profitable to offer FedEx and UPS last-mile delivery. The settled price reflects both sets of information, through negotiation. Please note that there is no discount or NSA pricing offered for rural deliveries. The Retail rate is paid.

   The requested information is commercially sensitive and public disclosure could place the Postal Service in a competitive disadvantage in the marketplace. The Postal Service will, however, work with the committee to make this information available to members on a confidential basis.

3. Last year, the legislation that the Senate passed required the USPS to go through a number of steps before closing rural post offices and ensured that interested parties had a meaningful opportunity to participate in the decision-making process.

   Don't you agree that before you start lowering the USPS service standards and consolidating your retail network, all other options should be explored, and affected parties should have a legitimate chance for their concerns to be heard?

   Answer:

   In considering how to ensure the Postal Service's long-term financial viability, all reasonable options should be considered.

   Since 2011, the Postal Service has worked closely with rural communities to provide retail services through various alternate access channels, such as Contract Postal Units, Approved Shippers, and Village Post Offices at local businesses. This enhances the degree of service available to community residents, even if the local

Post Office is required to discontinue. Stamp purchases—the single most common transaction over Post Office counters—can also be made at grocery stores and other retailers nationwide.

Regarding rural Post Offices, we have processes to solicit and consider community input. Indeed, based on the feedback from customers in rural communities, as well as from members of Congress, we fundamentally changed our approach towards rural Post Offices by adopting the Post Plan for operational Post Offices below a specified grade level. In lieu of a consideration for discontinuance of small rural Post Offices, the Post Plan maintains a retail presence in the community with hours that are aligned with actual earned workload. This allows the office to stay open while also reflecting the level of demand for the services provided by that office.

The Postal Service's decision to change service standards was made following careful consideration, and was based on the fact that the prior service standards necessitated the maintenance of a processing network that was simply too large based on current, and projected, mail volumes. Those service standard changes followed several rounds of notice and comment rulemaking. We also engage in processes to solicit and consider input from affected parties prior to closing specific mail processing facilities.

Response of the

Postal Regulatory Commission

to written post-hearing questions before the

U.S. Senate Committee on Homeland Security and Governmental Affairs

September 19, 2013 Hearing

On September 19, 2013, the Chairman of the Postal Regulatory Commission (Commission) participated in a hearing by the U.S. Senate Committee on Homeland Security and Governmental Affairs entitled "Outside the Box: Reforming and Renewing the Postal Service, Part I – Maintaining Services, Reducing Costs and Increasing Revenue Through Innovation and Modernization." On October 21, 2013, Chairman Carper submitted post-hearing questions from Chairman Carper, Ranking Member Coburn, and Senator McCain to the Chairman of the Postal Regulatory Commission for response. On behalf of the Commission, below are our responses to the written post-hearing questions.

Questions from Chairman Carper

Q: How are delivery times measured for purposes of determining compliance with delivery service standards? At what point is mail considered to have entered the mail stream for the purposes of calculating delivery time.

A: Delivery days measure the total number of days it takes for mail entered into the mailstream to be processed and delivered to its final destination. Delivery time begins when mail is accepted by the Postal Service. Methods used to document acceptance and measure delivery time differ according to the type of mail. For most residential and business mail, acceptance occurs after mail is entered into a collection box, lobby chute, collected by a carrier and brought to a sorting facility, or received over the counter at a post office. The Postal Service uses specified collection times to document which day a card, letter, or flat is considered accepted into the mailstream. Final collection times generally range from 10:00 am to 5:00 pm on weekdays (excluding holidays) and vary on Saturdays. For measuring purposes, mail placed into a collection box after the final collection time is considered accepted on the following day. Also, business mail collected by a carrier is considered accepted when the carrier returns to his/her postal facility.

Delivery days for most retail single-piece mail are estimated by an External First Class sampling system (EXFC), managed by an independent contractor, International Business Machines Corporation (IBM). This EXFC system drops test mail pieces into the mailstream and measures the number of days from deposit of mail in collection boxes to final delivery.

Commercial mail brought directly to a postal facility by the mailer or its mailing agent is considered accepted when mail is initially scanned by the Postal Service.

Scanning may occur at the loading dock when pallets of mail are taken off trucks or, depending on the level of sortation, when it is processed on the first sortation machine. The Postal Service uses Critical Entry Times (CETs) to document which day commercial mail enters the mailstream. As an example, presorted mail must be scanned prior to the established Critical Entry Time (CET) in order to be considered accepted on the day it was delivered to a postal facility. In general, CETs range from 8:00 am to 5:00 pm and vary according to sortation machine requirements.

Delivery times for most commercial mail are measured using a two-step measurement system. First, documented arrival times are used to start the measuring process and an Intelligent Mail barcode scan is used to stop the clock and record the elapsed time. Second, the time is added to an estimate of the time from the last processing scan to actual delivery to provide an estimate of total delivery time.

Delivery days do not include Sundays or holidays. For example, First-Class Mail with an overnight delivery standard accepted by the Postal Service on a Saturday before a Monday holiday will meet that standard if it is delivered on Tuesday.

Q: Has the Postal Regulatory Commission made any effort to assess end-to-end delivery times as experienced by individual customers, in contrast to delivery times as measured for purposes of determining compliance with delivery service standards? In other words, has the Commission looked at the full delivery time from when a piece of mail is transferred from the individual's possession into that of the Postal Service – e.g., when it is picked up by a letter carrier from a residential mail box, or deposited in a blue collection box, or dropped off at the local post office – to when it arrives at the recipient's address? Are you aware of others who may have examined end-to-end delivery times, including how such delivery times may be affected by changes in delivery service standards, reduction in number of processing facilities, and changes in critical entry times, and whether there are more pronounced effects in rural areas?

A: As discussed in the response to your previous question, delivery times are measured in number of delivery days, not calendar days. The Commission considered some issues related to assessing end-to-end delivery times as experienced by individual customers with respect to calendar days in Docket No. N2012-1. In that case, the Commission compared actual days to delivery for single-piece First-Class Mail before and after the revised service standards presented as part of the Postal Service's proposal to alter its mail processing and transportation networks. *See* PRC Docket No. N2012-1, Advisory Opinion on Mail Processing Network Rationalization Service Changes at 54-60 (March 24, 2011). However, the Commission analysis did not quantify the impact of changes to business rules such as "start time" on conformance with service standards, but rather focused on how many calendar days longer it will take for First-Class Mail to be delivered.

The Commission is not aware of others who may have examined end-to-end delivery times, including how such delivery times may be affected by changes in delivery service standards, reduction in number of processing facilities, and changes in CETs, or whether these have more pronounced effects in rural areas.

Q: Do you believe a Commission study to look at the effect of recent and proposed changes in postal operations on true end-to-end delivery times, as experienced by postal customers, would be useful in evaluating those changes?

A: The Commission believes that conducting such a study could be useful in evaluating the effect of recent and potential postal operational changes on delivery customers. It may allow Congress and postal customers to understand better how the recent and proposed postal operations changes actually impact or will impact the true delivery times experienced by individual postal customers. Undertaking any such study would have to balance the benefits of the possible information obtained with an assessment of the cost of such a study and the availability of current Postal Service data systems to provide such insights.

<u>Questions from Ranking Member Coburn</u>

Q: In your written testimony, you state that there is value in having a third party examine changes in delivery schedules – as evidenced by the discovery that it is important for medications to be delivered on Saturday. Do you think that, if not for the PRC, Congress would not have heard concerns about medications?

A: Mail users likely would have brought such concerns directly to the attention of Members of Congress. Having a third party review and examine the validity of concerns raised about major changes in postal operations, such as those related to medications, can help develop a balanced, in-depth picture in which potential alternatives to address such concerns can be identified and proposed.

Q: Is it the position of the Postal Regulatory Commission that the Postal Service's measures of elasticity are not operable? Has the Postal Regulatory Commission used the Postal Service's elasticity measures in recent dockets?

A: Under the current price-cap ratemaking system, the Commission makes limited use of the Postal Service's elasticity measures. In general, these measures are used to evaluate market dominant negotiated service agreements; estimate whether revenue from competitive product rate changes will cover the attributable costs of competitive products; and evaluate revenue generated from rate changes in exigent circumstances. For these limited situations, the measures are operable, though not ideal.

The Postal Service's elasticity estimates have not been updated to reflect the new products or rate categories created by the Postal Service since passage of the Postal Accountability and Enhancement Act of 2006.

In the Postal Service's FY 2012 Annual Compliance Report, it presented models to demonstrate the risk of above average rate increases for Standard Flats. The models used own-price elasticity to illustrate the impact of rate changes on flat mail volume. The Postal Service's elasticity estimates for Standard Mail are not disaggregated between letters and flats. The Postal Service assumed that Flats demand is more price elastic than other Standard Mail products. After evaluating the models, the Commission found that their usefulness would be significantly improved if estimates of own-price elasticity of demand were available by product and recommended that the Postal Service derive elasticity estimates to provide for a more realistic assessment of the impact of price changes on contribution.

Q: All else equal, does the Postal Service have an incentive to provide good service?

A: Yes. Quality service for products, market dominant or competitive, drives greater revenue. In addition, transparency requirements provided for in current law may further incentivize the Postal Service to maintain high quality service.

Q: Who do you believe is currently responsible for setting prices at the Postal Service?

A: Ultimate pricing accountability lies with the Governors. Under current law, the Postal Service has authority to set prices. There are multiple levels of management at the Postal Service that share in responsibility for setting prices. For certain prices, Postal Service management consults with its marketing, costing, and pricing departments, among others. Other prices, such as those not of general applicability also involve pricing negotiations with mailers. Some international prices are set pursuant to the Universal Postal Union (UPU).

Q: Do you think the price cap in place today has served the needs of the Postal Service well?

A: Implementation of the price cap has met the objective to maximize incentives to reduce costs and increase efficiency. 39 U.S.C. 3622(b)(1). However, it has not met the objective of allowing the Postal Service to retain earnings. 39 U.S.C. 3622(b)(5). Pursuant to 39 U.S.C. 3622(d)(3), in 2016 the Commission will begin a review of the system of regulating rates and classes for market dominant products, including the price cap, to determine whether it is achieving the objectives of section 3622(b), taking into account the factors set forth in section 3622(c). That review will include an opportunity for the Postal Service and the users of the mail to articulate advantages and disadvantages of the current system. The Commission recognizes that a majority of the Postal Service's operating losses have occurred from the market dominant category.

Q: Right now the PRC has 45 days to review price changes before-the-fact. Should this be longer or shorter?

A: The Commission believes that the current system requiring it to review annual limitation price changes prior to implementation in 45 days is appropriate. Mailers require notice from the Postal Service in advance of a rate adjustment to implement software and mail preparation changes, and the law gives mailers a minimum of 45 days' notice. Under normal circumstances, the Commission endeavors to complete its review of proposed rate adjustments in fewer than 45 days to give the Postal Service and mailers a chance to adjust plans should a rate, as proposed, not meet the requirements of the law.

<u>Questions from Senator McCain</u>

Q: Please provide the specific concerns of the Postal Regulatory Commission (PRC) with S. 1486, as well as recommendations to rectify the concerns of the PRC.

A: Senator McCain posed a similar question orally at the September 19, 2013 hearing asking the Commission to provide its response in writing. The Commission provided its written response on October 22, 2013 to the similar oral question posed at the hearing. If an additional supplemental response is desired, the Commission will provide one.

In closing, the Chairman appreciates the opportunity to provide these responses on behalf of the Commission. The Chairman and the Commission staff are always available to respond to any additional questions that the U.S. Senate Committee on Homeland Security and Governmental Affairs may have in the future.

OFFICE OF INSPECTOR GENERAL
UNITED STATES POSTAL SERVICE

November 22, 2013

The Honorable Thomas R. Carper
Chairman, Committee on Homeland Security
and Governmental Affairs
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

On October 21, 2013, you requested responses for the record to questions posed during your committee's September 19, 2013, hearing entitled "Outside the Box: Reforming and Renewing the Postal Service, Part I – Maintaining Services, Reducing Costs, and Increasing Revenue through Innovation and Modernization." The responses to the questions are enclosed.

We appreciate the opportunity to answer these questions for the record. If you have any questions, please contact Mohammad Adra, Assistant Inspector General for the Risk Analysis Research Center or me at (703) 248-2100.

Sincerely,

David Williams

David C. Williams
Inspector General

Enclosures

cc: The Honorable Tom Coburn
Ranking Member

Post-Hearing Questions for the Record
Submitted to Hon. David Williams
From Ranking Member Tom A. Coburn

"Outside the Box: Reforming and Renewing the Postal Service, Part I – Maintaining Services, Reducing Costs, and Increasing Revenue Through Innovation and Modernization"

September 19, 2013

1. During your oral testimony, you described the comments and questions of Senator McCaskill as "fascinating." The subject was the contractual relationship the Postal Service has with other entities, such as UPS and FedEx. Is it your understanding that the ability to enter contracts is advantageous for the Postal Service? Do you believe any additional regulatory factors should be imposed on these types of contractual relationships?

Response:

Senator McCaskill's question illuminated the interesting problem of what happens when well-intended goals come into conflict with one another. The Postal Service exists to enable the public and commerce. Caring for its workforce is also important. As this applies to the Postal Service's parcel business, there can sometimes be conflicts between providing the lowest possible rates for citizens while enabling parcel carriers by providing last mile service to areas that they find difficult and expensive to serve. There can also be conflicts in caring for the postal workforce while enabling competitors. As a result, policies can be complex.

The Postal Service provides special rates for large bulk mailings through discounts for mail preparation and transportation, as well as, negotiated service agreements with mailers. The Postal Service's competitors, like other large mailers, are able to take advantage of the discounted prices for activities such as transporting mail close to its final destination. These rates are lower than those available to a citizen with a single package to mail from point to point, yet citizens can benefit when the Postal Service delivers additional last-mile pieces, because it spreads the total cost of delivery to a residence over more pieces, keeping prices reasonable. Incentivizing large volumes of mail and parcels helps the public in that it finances universal service without resorting to appropriated funds.

Another dynamic involves "co-opetition." Should the Postal Service enable its competitors or make them compete for parcel business in geographic areas that are unprofitable to serve? The Postal Service is barred by title 39 from unduly discriminating against any particular customer, including its competitors. Even with the freedom to exclude competitors, answering the question of what would happen if the Postal Service were to stop offering last-mile discounts is complicated. Would postal employees be advantaged if the Postal Service's parcel business grew at the expense of competitors or would they be disadvantaged if there were fewer parcels to deliver, even with higher margins? The mailers and the public on the other hand would probably universally prefer choice and competition among shippers. That was the original purpose of the Postal Service's entering the parcel business, since abusive monopolistic conditions were forming in the United States.

Post-Hearing Questions for the Record
Submitted to Hon. David C. Williams
By Senator Claire McCaskill

Thursday, September 19, 2013
United States Senate, Committee on Homeland Security and Governmental Affairs

The bill we are going to be considering soon contains numerous reforms on both the cost side and the revenue side. I think that if the USPS adopts a lot of these, they may not have to start degrading their services and move to 5-day delivery. As someone who has audited the USPS, you are in as good a position as anyone to tell us whether the other available changes will be enough to make the US Postal Service viable long term.

Q. If the US Postal service makes the changes to the retiree prefunding requirements, cluster box delivery is implemented where appropriate, and the USPS takes the opportunities presented in the bill to offer non-postal service and beginning shipping wine, beer and distilled spirits, do you believe that additional service cuts and delivery standard degradation are necessary for the USPS's long-term stability?

Response:

The Postal Service has taken substantial cost cutting measures to date, but there are additional measures available that represent very significant opportunities. Clusters of smaller opportunities also exist that, when taken together, represent significant cost saving options as well.

As you mentioned in the question, there are also opportunities to increase revenues in the proposed bill through allowing new Postal Service products and services. In addition, the bill offers more flexibility in determining price increases. Together, these represent a large menu of options for balancing costs with revenues.

Unfortunately, even if future losses are stemmed, the Postal Service is now left with substantial debt and has neglected infrastructure investments needed to maintain its delivery vehicles, buildings, and equipment. The absence of funds has also hampered the development of new products, particularly those that respond to the emerging needs associated with globalism and the digital age. Lastly, the Postal Service has concluded, along with most other world posts, that letter mail declines are likely to continue for a number of years, as a result of the ongoing digital revolution.

The Postal Service has suggested among other changes 1) reducing service on most deliveries to 5 days and 2) introducing changes to health care benefits for employees as measures that they believe would be most useful in returning to profitability. The Postal Service believes that the two measures would be valued at $10 billion annually.

Delivery is currently a significant expense for the Postal Service. If the modes of delivery were optimized, the annual savings has been estimated by our office to be $4.5 billion. This change would entail moving mail delivery in locations where door delivery is occurring from the doorway to the property line. If all mail practicable were delivered to cluster boxes, the savings is estimated to total $9.6 billion. The measures would also provide health and safety benefits for mail carriers, who would be spared from climbing flights of stairs to deliver mail to the door and inside the residences along their routes. However, the current proposed Senate legislation calls only for the voluntary conversion of residential door deliveries to curbside or cluster boxes. The savings associated with voluntary conversions instead of legislatively-mandated conversions is not known.

If the determination were made that a reasonable level of prefunding has now been set aside and the prefunding effort concluded, the result would be a reduction of the Postal Service's current expenses of more than $5.5 billion annually. If the current overfunding were returned, the result could be a one-time refund of $6 to $12 billion. I believe a compelling case could be made for such actions.

The retiree benefit plans are currently prefunded at unprecedented levels rarely if ever found within the private sector, in the federal government, or at state and local levels. The Postal Service has set aside $334 billion for the prefunding effort so far. The Office of Personnel Management (OPM) has estimated the liability for all the retiree benefit funds at $402 billion. If the estimate is accurate, the plans are prefunded at more than 80 percent of the liability, and even without additional contributions, the funds are earning interest. In contrast, the federal government has prefunded its own pension programs by only 40 percent and does not prefund retiree health at all.

Additionally, OPM's efforts to estimate the exact liability have proven to be very difficult and plagued with errors. Even accurate estimates are given to volatile swings in response to changing external factors, such as interest rate assumptions. Currently, interest rates are being held at a low level to stimulate the economy. Low rates are causing the retiree benefit fund liabilities to appear larger than they are likely to ultimately be. If interest rate assumptions were higher by 1.25 percent, the combined benefit funds would already be currently overfunded. For instance, from 1971 to 2011, the annual interest earned on the pension funds averaged more than 2 percentage points higher than the interest rate assumption used now. If the current interest rate assumptions matched these historic rates, the plans would be significantly overfunded today.

Also, substantial errors have occurred in the past. In 2002, the pension fund was found to be on track to be overfunded by $78 billion. A special analysis by OPM found the error. OPM undertook the analysis at the urging of the Government Accountability Office (GAO) who had mistakenly concluded that the Postal Service was underfunding the plans instead of overfunding them. More recently, our office raised concerns about the healthcare inflation assumptions that OPM was using to calculate the Postal Service's liability for retiree health. OPM later adjusted the healthcare trend assumptions it used, adopting an ultimate rate that was several percentage points lower, reducing the estimates of the Postal Service's liability. Lastly, government-wide assumptions are currently used to calculate the Postal Service's liability even though the postal workforce has different characteristics than the rest of the federal workforce.

Our office has found that if Postal Service-specific assumptions were used instead, the Postal Service's liability for pensions and retiree health would be reduced by $8 billion. The purpose of describing this is to point out that the quest to prefund at the level of 100 percent of liability has been elusive, as well as, extremely expensive. There are also choices available to address the liability after the prefunding effort is concluded. For example, the $47 billion now set aside in the retiree health fund earns more than $1.5 billion in interest each year without the prefunding payments. The requirement to prefund retiree health liability could be halted, and the retiree health fund set aside as a growing reserve, while the Postal Service's payments for retiree health premiums continue. This would allow the Postal Service to devote more resources to modernizing its infrastructure for the future instead of putting aside more funds for a liability of uncertain size.

In the area of new products, I agree that opportunities exist as a result of the evolving societal needs associated with the 21st Century. The technologies associated with the digital age and the substantial increases in parcel shipping because of e-commerce and globalism present opportunities for revenue, and also pose significant challenges to American citizens and commerce. Other world posts have been an important part of solutions to meet those challenges for their nations. Moving the Postal Service into this space is likely to contribute greatly to success of American commerce and our citizens.

There are choices with regard to balancing revenues and costs. I agree with the Postal Service that the choices ahead now involve tradeoffs and will likely all be controversial. The cost reductions associated with mandating modes of delivery and concluding the prefunding effort would provide substantial cost savings. However, the Postal Service's financial debt and pent-up need for infrastructure investments, combined with the uncertainty of continuing future losses in mail volume, make it difficult to determine how many measures are needed to return the Postal Service to profitability.

American Postal Workers Union, AFL-CIO

1300 L Street, NW, Washington, DC 20005

Mark Dimondstein
President

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December 3, 2013

The Hon. Thomas R. Carper, Chairman
Committee on Homeland Security and Government Affairs
United States Senate
Washington, DC 20510-6250

Re: APWU Responses to Post-Hearing Questions for the Record Directed to Mr. Cliff Guffey

Dear Chairman Carper:

I am writing on behalf of the American Postal Workers Union, AFL-CIO (the APWU) in response to Post-Hearing Questions for the Record Submitted to Mr. Cliff Guffey from Ranking Member Tom A. Coburn. Our answers to Dr. Coburn's questions are enclosed for the record in the September 19, 2013, hearing "Outside the Box: Reforming and Renewing the Postal Service, Part I – Maintaining Services, Reducing Costs, and Increasing Revenue Through Innovation and Modernization."

Thank you for considering our views on these important matters.

Very truly yours,

Mark Dimondstein

Mark Dimondstein
President

Enclosure

MD/lbb
opeiu#2, afl-cio

APWU Responses to

Post-Hearing Questions for the Record
Submitted to Mr. Cliff Guffey
From Ranking Member Tom A. Coburn

"Outside the Box: Reforming and Renewing the Postal Service, Part I – Maintaining Services, Reducing Costs, and Increasing Revenue Through Innovation and Modernization"

September 19, 2013

1. In your testimony, you argue that a third party arbitrator should not be given authority to "cut your benefits." Should the USPS prioritize employee benefits over its financial well-being and ability to continue operating and serving the American people?

   Answer: Your question poses a false dichotomy. Benefits paid to APWU bargaining unit members are not the reason the Postal Service is in financial difficulty. APWU bargaining unit members are the most productive postal workers in the world. If the Postal Service is given flexibility to raise its rates in a market-sensitive way without the artificial constraint of the CPI cap in present law, it will be able to continue providing universal postal service at uniform rates to the American public.

2. In your written testimony you advocate repeal of the pre-funding mandate for retiree health benefits. Do you agree that it is prudent for the Postal Service to set aside money so that current employees can enjoy anticipated benefits in retirement? If money is not set aside, what entity would pay for these benefits when they are claimed?

   Answer: We fully expect the Postal Service to pay retiree health benefits as they always have. At this time, the Postal Service has over-funded its retirement obligations in CSRS and FERS, and it has pre-funded approximately 50 percent of the present value of its retiree health benefits obligations. No other agency or company has funded its pension and retiree health benefits obligations to this extent. The present law and current administrative practices that have required this over-funding are unfair to postal customers and pose a threat to the Postal Service. We believe there is now a strong consensus in the postal community that this unfair situation must be corrected through appropriate legislation.

3. Do you believe the nearly $18 billion in unfunded liabilities the Postal Service has for its Federal Employees Workers' Compensation claims should be pre-funded?

   Answer: No, such a requirement would pose yet another unprecedented and unwarranted burden on postal ratepayers. Legislation that provides the Postal Service sufficient discretion in setting its rates will obviate questions such as this.

Post-Hearing Questions for the Record
Submitted to Ms. Jeanette Dwyer
From Ranking Member Tom A. Coburn

"Outside the Box: Reforming and Renewing the Postal Service, Part I – Maintaining Services, Reducing Costs, and Increasing Revenue Through Innovation and Modernization"

September 19, 2013

1. You state in your testimony that you oppose efforts to remove the cap. This is the opposite conclusion that Mr. Guffey came to in his testimony. Why is Mr. Guffey wrong?

   Answer). I feel any legislation that is passed must maintain some form of price cap to ensure that customers continue to use the Postal Service to deliver their products. Without a pricing index, the mailers would be faced with uncertainty when budgeting for future fiscal years that would result in a loss of mail through the system, and more importantly, customers. I do feel, however, that the current pricing index being used is the wrong index for the Postal Service.

2. Reform is about mutual sacrifice and tradeoffs. Ms. Dwyer, if it is your contention the cap should stay in place, which would allow more revenue, please describe what cuts you will support instead.

   Answer).I don't support any additional cuts to the Postal Service's network. Rural letter carriers, as well as the other postal unions, have already put their "pound of flesh" on the table. Recent financial data released by the USPS shows a profit can be made doing what the USPS was created to do.

3. Do you have a recommendation as to how a new price cap should be constructed? Are you referring to a mechanism in the Office of Inspector General paper entitled "Revisiting the CPI-Only Price Cap Formula"?

   Answer). The NRLCA has been working with the other postal unions to offer a proposal we feel would put the USPS back on track to solvency. Within this proposal, we propose replacing the Consumer Price Index for all Urban Consumers in the price indexing system with the Producer Price Index for Delivery and Warehouse Services. We feel this index better reflects the daily work the USPS does day-in and day-out.

4. Although you recommend that an undefined cap be imposed on the Postal Service, you mention a "one-time postage review" to occur prior to this imposition of a cap.

   a. Please describe how this "one time" review would be conducted.

Answer). The Postal Service should be given the right to adjust its rates with a one-time proceeding before the Postal Regulatory Commission. The omnibus postage rate review and adjustment that was authorized by the PAEA should be conducted in 2013. If Congress insists on the prefunding mandate, then it is only fair that at least some of the prefunding cost be built into the postage rates the Postal Service charges its customers. A one-time rate case proceeding is needed to provide reasonable balance to the huge sacrifices postal employees have made during recent contract negotiations. This "one time" rate review would adjust and modernize all classes of postage rates.

b. Would the price adjustment resulting from that review be intended to result in "breakeven" for the Postal Service? Or some other financial target?

Answer). It would have a financial target that would allow the USPS to make a profit and bank savings to be used to pay down debt, modernize their infrastructure, or allow the USPS to grow and expand its business.

Post-Hearing Questions for the Record
Submitted to Mr. John Breeder
From Ranking Member Tom A. Coburn

"Outside the Box: Reforming and Renewing the Postal Service, Part I – Maintaining Services, Reducing Costs, and Increasing Revenue Through Innovation and Modernization"

September 19, 2013

1. Generally, how do businesses set their prices, or the amounts that they charge for their services? Do they have an outside entity that tells them what they can charge, or do they decide that themselves?

Answer:

Businesses that do not enjoy monopoly privileges and who have management and a board that are fully accountable to shareholders for poor decisions have the ability to set their own prices.

Entities such as public utilities with dominance over certain markets are subjected to oversight of their prices by utility commissions or other authorities.

The Postal Service, having been established as a government-sponsored enterprise with broad monopoly powers over the carriage of letters and the mailbox and having no residual claimants such as a group of shareholders to ensure management accountability and good stewardship of that monopoly, are appropriately subject to the Postal Regulatory Commission but are essentially free to set their own prices for competitive mail.

Post-Hearing Questions for the Record
Submitted to Mr. John Beeder
From Senator Claire McCaskill

"Outside the Box: Reforming and Renewing the Postal Service, Part I – Maintaining Services, Reducing Costs, and Increasing Revenue Through Innovation and Modernization"

September 19, 2013

I continue to believe, that moving to 5-day mail delivery could help push the US Postal Service into a "death spiral" that it will not be able to recover from. In 2011, GAO seemed to echo these concerns, noting that USPS estimates may have understated the reduction in volume likely under 5-day service.

It is counterintuitive to me that the USPS leadership seems to be going out of its way to make the product worse by reducing delivery days and standards in the belief that this will help the long-term outlook of the Postal Service. I cannot think of too many examples of private sector businesses that intentionally degrade their products – and make no mistake, that is what the USPS is doing by lowering service standards and giving up Saturday delivery – and end up better off in the long run.

Can you think of any examples where this has worked?

Answer:

I am unaware of any example where service reduction or product quality degradation have been effective in responding to declining product demand. This is certainly not a path that the greeting card industry has pursued in response to very similar challenges. Rather the industry has worked to bring the average cost of holiday cards down while maintaining product quality and bringing new and innovative products to market.

While comparisons with foreign posts are difficult due to differences in size and scope and product offerings, I note that posts that have reduced delivery days such as Canada and the Netherlands continue to suffer from cost and revenue issues. In the case of the Netherlands, they have recently sought to reduce delivery days to only three while seeking a 22% increase. We believe higher prices and reduced service will only serve to worsen the USPS' problems.

Responses of Jerry Cerasale
To Post-Hearing Questions Submitted by Senator Tom A. Coburn
"Outside the Box: Reforming and Renewing the Postal Service, Part I—Maintaining Services, Reducing Costs, and Increasing Revenue Through Innovation and Modernization"

1. During the hearing, Dr. Coburn and Mr. Cerasale had a discussion of the portion of the economy that is postal-related. Mr. Cerasale's written testimony included the following: "...we are a $1.3 trillion industry that employs nearly 8 million private sector workers, and constitutes some 9% of GDP."

   a. Please provide the source for this information.
   b. Please break-out the $1.3 trillion by type of industry.
   c. Is it your position that none of this $1.3 trillion is included in the other 91% of GDP?
   d. If your answer to c. is no, how much of the 9% is included elsewhere?
   e. If your answer to c. is yes, how can you be sure that any subset of these industries in your response to subpart b. is not included in that other "91%"?

Answer 1.

a. The information used to prepare my testimony was from a study conducted by the Envelope Manufacturers Association Foundation. A copy of the information used is attached to my responses.
b. The information attached in response to subpart a. contains a break-out of the industry categories in the $1.3 trillion estimate from the EMA Foundation study.
c. Based upon the EMA Foundation Study and my discussions with EMA staff, yes.
d. N/A.
e. My response to subpart c. is based upon the EMA Foundation Study. The impact was calculated in the study and then compared to GDP as a whole. The study did not recalculate GDP. Thus, there is no double counting.

2. In your oral testimony, you mentioned a Standard Flats price increase incurred by catalogs in 2007. Were the rate recommended by the Postal Rate Commission (and then implemented) higher than those that were proposed by the Postal Service? Which set of prices would you have preferred?

Answer 2.

The price increases implemented by the Governors of the Postal Service for Standard Flats in 2007 were recommended by the Postal Rate Commission (PRC) and were higher than the prices proposed by the Postal Service. The members of the Affordable Mail Alliance would have preferred the prices proposed by the Postal Service. Our members communicated that fact to the Governors of the Postal Service and urged them to reject the prices and use their statutory authority to modify those recommended prices to avoid the significant mail volume losses that would occur otherwise. Sadly, the Governors chose not to exercise that statutory authority instead deciding to implement the higher prices thereby causing the significant mail volume drop.

3. In your testimony, you advocated retention of the CPI-based price cap. Is it your understanding that the composition of that index mirrors the cost structure of the Postal Service? Is there an index that would be more appropriate?

Answer 3.

While there is no perfect index to mirror the Postal Service cost structure, I believe that the current CPI index remains the most appropriate. When the Postal Accountability and Enhancement Act (PAEA) was considered by Congress, a number of different indices were discussed. It was determined that CPI was the most appropriate index because it did reflect a significant portion of the Postal Service cost structure, it best mirrored the cost structure facing Postal Service customers, and it was not a volatile index, as compared with the index for delivery services, allowing for greater predictability of postage rates for both mailers and the Postal Service. Moreover, the PAEA was designed to move away from cost of service model pricing. An index that perfectly mirrored Postal Service costs would revive cost of service pricing and would remove the incentive for the Postal Service to keep costs under control and reap the reward of any profit obtained.

4. Do you truly believe the Postmaster will raise prices to the point where it cripples the Service as a whole?

Answer 4.

Customers of the Postal Service have seen the Governors of the Postal Service implement postage rates that are crippling. As noted above, they failed to exercise their statutory authority to modify a disastrous Standard Flat postage increase. Right now Postal Service customers are facing a 3.5 times inflation postage increase just at a time when mail volume in Standard and Parcels is growing and the decline in First-Class Mail has slowed. We believe that, if approved, this increase will lead to a counterproductive fall of in mail volume and a continuation of the Postal Service's financial woes. The Service is coming off a better than expected fiscal year in which the rate stability of the past few years was a positive contributing factor.

Further, it is well accepted in economic literature that monopolists can and do make pricing decisions that a competitive business would not make. I firmly believe that the Postal Service is a monopolist, behaves like a monopolist, and continues to value and protect its monopoly power. Under current law, the Postal Service has the authority to suspend its two monopolies (letter delivery and mail receptacle). Yet the Service has not suspended either monopoly and shows no interest in doing so. Therefore, the Service believes that its monopolies are economically valuable, and it acts accordingly.

5. We heard earlier from the IG about the 20 years of data it combed through to ultimately find small price increases are a positive thing for the Service. We have heard the opposite from you. What body of research and evidence are your assertions founded upon?

Answer 5.

The Affordable Mail Alliance and, I believe, the Congress agree that small price increases are appropriate for the Postal Service. Thus, we support the CPI cap. I do not believe that a 3.5 times inflation price increase is a small one. As I understand the Inspector General's (IG) study, postage increase in the earlier years reviewed were before the advent of electronic diversion which has had a significant impact on mail volumes. In the years since that impact began, postage increases have been small. Since the current exigent postage increase proposal is not small and would occur in the context of increased digital alternatives, I believe that the conclusion of the IG based upon his review is not applicable to the exigent increase request, as my understanding is that the data analysis conducted by the IG's contractor did not review any cross-elasticities with other products. Therefore, the data ignored smartphones, tablets, mobile commerce, pay-pal, etc. The study is an excellent review of history that has not been updated for today's reality, and, thus, it cannot be applied directly to analysis of the current postage situation.

Finally, as I indicated above, the Postal Service has two statutory monopolies that it has chosen to retain and protect. The actions of the Postal Service indicate that it is and considers itself a monopoly. The Service can maintain for the foreseeable future significant market power over the delivery of, not only, letter mail, but also all mail with its control of the mail receptacle. Therefore, I rely upon the significant economic research on monopolies and their use (or abuse) of monopoly power.

EMA Foundation's
Institute of Postal Studies Presents:

2012 Mailing Industry Job Study

EMA FOUNDATION

Mailing Industry Provides Significant U.S. Jobs

The U.S. mailing industry consists of:
8.4 million mailing industry jobs

The U.S. mailing industry provides:
6% of the nation's jobs

Mailing Industry is Critical to the Economy

The U.S. mailing industry contributes to the economy with:

$1.3T in sales revenue,
and
over 8.6% of U.S. GDP.

Mailing Industry Depends on the USPS

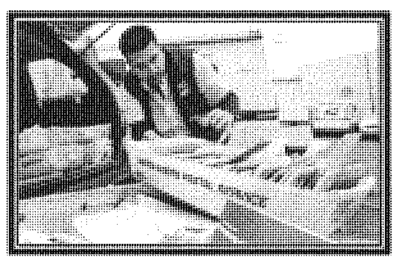
Policies that have a dramatic influence on the USPS and mailing industry impact many workers.

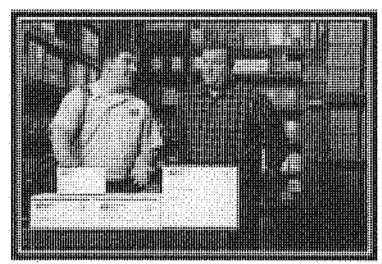
Over 76% of mailing industry jobs depend upon the delivery infrastructure of the USPS.

2012 vs. 2010 Mailing Industry Job Comparison

The mailing industry provided:

- 8.4 million jobs in 2011 vs. 8.8 million jobs in 2009
- $1.3 trillion in sales revenue in 2011 vs. $1.2 trillion in sales revenue 2009

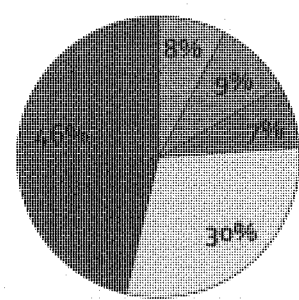




Mailing Industry Job Summary Distribution

- Postal Service at 8%
- Private Sector Delivery (FedEx, UPS) & suppliers at 9%
- Paper, Printing, Printing & Paper Industry Suppliers, & Direct Mail Design at 7%
- Management of Mail in all Industries at 30%
- Sales of Products and Services through Mail-Stream at 46%

76% of the 8.4 million jobs are in firms <u>dependent upon</u> the delivery infrastructure



Private industry accounts for 92% of the jobs.

Postal service accounts for 8% of the jobs.

Overall Comparison - 2012 vs. 2010 Results

- **Decline in Jobs**
  - ↓Postal Service
  - ↓Paper, Printing and Industry Suppliers
  - ↓Mail Management in Business to Business Transactions
  - ↓Traditional Direct Mail, Catalog, and Magazine
- **Growth in Jobs**
  - ↑Private Mail Centers (i.e. Fed-ex, UPS)
  - ↑Electronic Shopping and Mail Order Houses (i.e. Amazon)
  - ↑Retail Sales Jobs at Retailers of Products Delivered through the Mail Stream

Detailed Data & Methodology

FOUNDATION

Mailing Industry Job Categories

Jobs decreased by 4.5% totaling nearly 400,000 jobs due to losses of jobs in all major categories with the greatest loss in manufacturing jobs.

Categories	2009 # of Jobs	2011 # of Jobs	% Change	# of Jobs
Manufacturing - Mail Production, Distribution and Handling	2,186,216	2,013,070	-7.9%	-173,146
Management of Mail in all Industries	2,633,694	2,515,679	-4.5%	-118,015
Sales of Mail Delivered Products & Services	4,004,194	3,901,002	-2.6%	-103,192
Total	8,824,104	8,429,751	-4.5%	-394,353

Mail Production, Distribution and Handling

With the loss of overall mail volume, mail production, distribution, and handling jobs have also been reduced.

- **Jobs with Mail Production, Distribution & Handling dropped 7.9% with a 173M job loss.**
- **Some of the major job losses included:**
  - Postal Service with 72M jobs at a loss of 9.9%
    - From 720,200 jobs in 2009 to 648,350 jobs in 2011
  - Private Sector Delivery with 31M jobs at a loss of 5.2%
  - Paper, Printing, Printing Industry Suppliers, & Direct Mail Converting & Management with 80M jobs at a loss of 11.4%

Management of Mail
(Business to Business Interaction)

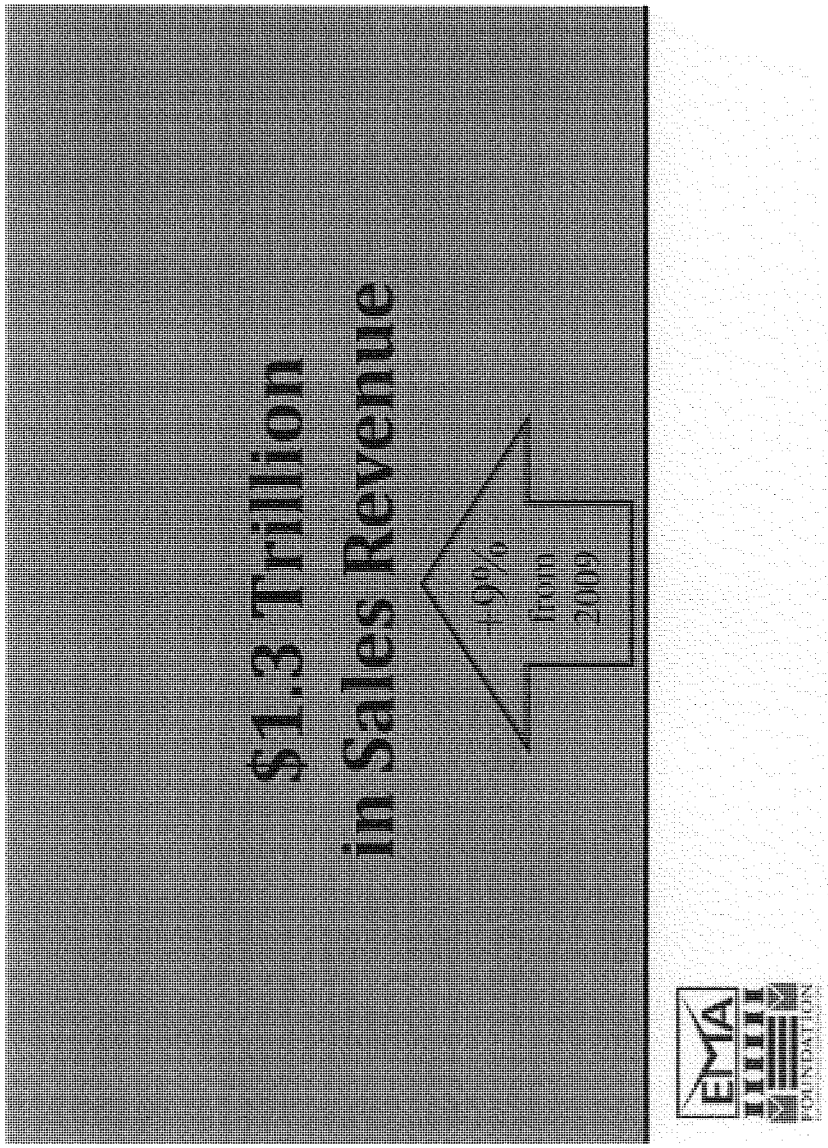
As businesses have moved to email interaction, there are less business to business jobs associated with mailing letters and packages.

- **Management of Mail in all Industries dropped 4.5% with a 118M job loss.**
  - This trend is expected to continue as businesses move to more email interaction as opposed to traditional mail.

Sales of Mail Delivered Products

Delivered product sales are not only originating from printed catalogs, magazines, and direct mail but are now also originating through the internet (on-line sales) which are still delivered through the mail stream

- **Jobs with Mail Delivered Products dropped 2.9% with a 103M job loss.**
  - Some of the major job losses included:
    - Catalog direct mail generated sales at a loss of 5.4%
    - Direct response magazine ad sales at a loss of 13.7%
  - As expected, some of the job gains included products that are shipped to homes and businesses due to ordering through the internet; however, these categories are still considerably smaller:
    - Electronic shopping & mail order houses at a gain of 3.9%
    - Internet retail sales from traditional stores at a large gain of 26.5%


$1.3 Trillion
in Sales Revenue
+9%
from
2009
EMA
FOUNDATION

Sales Revenue Categories

Sales revenue increased by 9% due to more packaged products being delivered through the mail stream.

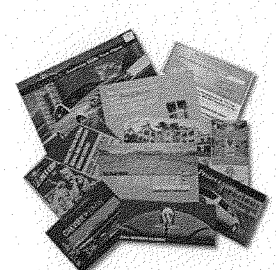
Categories	Description	2009 Sales ($ Billions)	2011 Sales ($ Billions)	% Change	Sales ($ Billions)
Mail Production, Distribution and Handling	Producing the Mail	$117.10	$113.05	-3.6%	-$4.05
	Delivering the Mail and Parcels	$143.96	$145.08	0.8%	$1.12
Sales of Mail Delivered Products & Services	Sales of Products / Services Delivered by the Mailing Industry	$908.21	$1,032.27	12.0%	$124.05
	Total	**$1,169.27**	**$1,290.39**	**9%**	**$121.12**

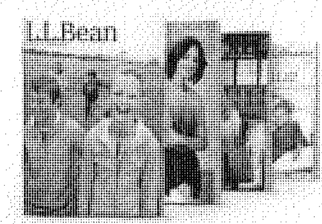
Mail Production, Distribution & Handling

- **Mail Production, Distribution & Handling**
  - Producing the Mail had a sales revenue drop of 3.6%.
  - Delivering the Mail had a sales revenue gain of +0.8%.
    - Some of this small gain may be attributed to the higher price of delivering packages.

Sales of Mail Delivered Products & Services

- **Sales of Mail Delivered Products & Services had an overall sales revenue increase of 12.0%.**
  - Significant gains were observed with:
    - Direct mail at 12% with total sales revenue generated of $506 billion
    - Catalogs at 12% with total sales revenue generated of $126 billion
    - Electronic Shopping and mail-order at 29% with total sales revenue generated of $221 billion





METHODOLOGY FOR CALCULATING JOBS AND ECONOMIC IMPACT

EXECUTIVE SUMMARY

EMA Foundation's Mailing Industry Job Study's goals were to 1) identify the jobs and revenues that are associated with the mailing and delivery industries and to 2) allocate these jobs and revenues to Congressional Districts.

Jobs associated with the mailing industry are contained in two categories: 1) those that are associated with the creation of mail or the handling, distribution, delivery or receipt of mail and parcels; and 2) jobs associated with firms whose sales depend on mail and parcel carriers to deliver products that they sell or that use mail advertising to sell their products or services.

Most of the jobs identified in this study exist today because mail is the most efficient means for many individuals, private sector firms, governments and non-profit entities to communicate, advertise or distribute their products to customers. The study concludes that mail continues to be a significant presence in the United States economy today.

ESTIMATION OF MAIL INDUSTRY JOBS

Jobs are associated with mail both directly through the handling, distribution, delivery or receipt of mail and indirectly through jobs that exist because the Postal Service and its competitors are selling a service that distributes advertising that generates sales and delivers parcels to households and businesses. This study combines data from Bureau of Labor Statistics, the Bureau of Economic Affairs, the Census Bureau the Direct Marketing Association, and the Postal Service in order to derive an estimate of the jobs associated with the mailing industry.

The type of jobs and tbe sources are provided in the following table.

Mailing Industry Jobs Summary

Group A - Mail Production and Distribution and Handling	Sources	# of Jobs (2009)	# of Jobs (2011)	% Change	# of Jobs
1) Postal Service	Occupational Employment Statistics Program & USPS	720,200	648,350	-9.9	-71,850
2) FedEx and Postal Service Suppliers	USPS Cost Segment and Components Report	170,209	179,386	5.4	9,177
3) Private Sector Delivery (FedEx, UPS)	Bureau of Labor Statistics	596,571	565,659	-5.2	-30,913
4) Paper, Printing, Printing Industry Suppliers, Direct Mail Design	Occupational Employment Statistics Program	699,235	619,675	-11.4	-79,560
Total		**2,186,216**	**2,013,070**	**-7.9**	**-173,146**

Group B - Management of Mail in all Industries	Reference	# of Jobs (2009)	# of Jobs (2011)	% Change	# of Jobs
Mail Management in all Industries	Occupational Employment Statistics Program	2,353,794	2,226,179	-5.42%	-127,615
Self Employed Mail Intensive	Bureau of Labor Statistics	279,900	289,500	3.43%	9,600
Total		**2,633,694**	**2,515,679**	**-4.48%**	**-118,015**

Group C - Jobs Due to Sales of Products / Services Delivered by the Mailing Industry	Reference	# of Jobs (2009)	# of Jobs (2011)	% Change	# of Jobs
Non-Catalogue Generated Sales	DMA "Power of Direct Marketing"	2,556,768	2,476,900	-3.12%	-79,868
Catalogue direct mail generated sales	DMA "Power of Direct Marketing"	625,481	591,700	-5.40%	-33,781
Direct Response Magazine Ad Sales	DMA "Power of Direct Marketing"	424,181	365,900	-13.74%	-58,281
Insert Advertising Sales	DMA "Power of Direct Marketing"	126,000	123,900	-1.67%	-2,100
Publishing of Periodicals/Books, Greeting Cards/Directories	Economic Census & BLS Survey	120,552	116,776	-3.13%	-3,776
Electronic Shopping and Mail Order Houses (i.e. EBay, Amazon, etc.)	U.S. Census Monthly Retail Trade Report, and E-commerce Annual and Quarterly Reports	151,212	157,160	3.93%	5,948
Retail Sales at Retailers with Stores Delivered by the Mailing Industry (i.e. Macy's)	U.S. Census Monthly Retail Trade Report, and E-commerce Annual and Quarterly Reports	54,275	68,666	26.51%	14,391
Total Jobs Due to Sales of Products and Services		**4,004,194**	**3,901,002**	-2.58%	-103,192

Summary		# of Jobs (2009)	# of Jobs (2011)	% Change	# of Jobs
Total Jobs		**8,824,104**	**8,429,751**	-4.47%	-394,353

ESTIMATION OF MAIL INDUSTRY REVENUE

Revenue was calculated for three types of firms that make up the industry: 1) industry suppliers, 2) delivery, and 3) mail intensive users. Industry suppliers include firms that provide a service or product associated with creating mail. Delivery includes the United States Postal Service and other private sector delivery services. Mail intensive users are firms that use the mail to deliver advertising such as direct mail and catalogs to generate sales.

The amounts of revenue per category are provided in the following table.

Mailing Industry Revenue Summary

Group A - Mail Production and Distribution and Handling	Reference	Impact (2009)	Impact (2011)	% Change	$
Producing and Delivering Mail					
Production of Mail					
Direct Marketing Expenditures	DMA "Power of Direct Marketing"	$ 27.51	$ 24.22	-13.6%	-$3.29
Printing and Paper	Economic Census	$ 89.59	$ 88.84	-0.8%	-$0.76
Subtotal		$ 117.10	$ 113.05	-3.6%	-$4.05
Delivery					
Private Sector Delivery (includes UPS & Fed-Ex)	Economic Census	$ 73.12	$ 77.58	5.8%	$4.46
Postal Service	USPS Annual Report	$ 68.09	$ 65.54	-3.9%	-$2.55
Private Mail Services	Economic Census	$ 2.75	$ 1.95	-40.8%	-$0.80
Subtotal		$ 143.96	$ 145.08	0.8%	$1.12

Group B - Management of Mail in all Industries	n/a	n/a	n/a	n/a	n/a

Group C - Sales of Products / Services Due to Advertisements Delivered by the Mailing Industry	Reference	Impact (2009)	Impact (2011)	% Change	$
Non-catalog Direct Mail	DMA "Power of Direct Marketing"	$ 445.80	$ 504.50	11.6%	$58.70
Catalogs	DMA "Power of Direct Marketing"	$ 110.50	$ 126.10	12.4%	$15.60
Direct Response Magazine - Ad in Magazine	DMA "Power of Direct Marketing"	$ 68.44	$ 69.60	1.7%	$1.16
Insert Media - Insert in Newspaper	DMA "Power of Direct Marketing"	$ 23.90	$ 24.70	3.2%	$0.80
Greeting Card Publishers	Bureau of Labor Statistics	$ 4.86	$ 4.05	-20.0%	-$0.81
Periodical Publishers	Bureau of Labor Statistics	$ 42.78	$ 39.33	-8.8%	-$3.45
Book/Directory/List Publishers	Economic Census	$ 55.00	$ 42.61	-29.1%	-$12.39
Electronic Shopping and mail-order	U.S. Census Monthly Retail Trade Report	$ 156.93	$ 221.37	29%	$64.44
Subtotal Sales of Goods and Services		$ 908.21	$ 1,032.27	12%	$124.05

Summary		Impact (2009)	Impact (2011)	% Change	$
Total Revenue		$ 1,169.27	$ 1,290.39	9%	$121.12

OUTSIDE THE BOX: REFORMING AND RENEWING THE POSTAL SERVICE, PART II—PROMOTING A 21ST CENTURY WORKFORCE

THURSDAY, SEPTEMBER 26, 2013

U.S. SENATE,
COMMITTEE ON HOMELAND SECURITY
AND GOVERNMENTAL AFFAIRS,
Washington, DC.

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

Present: Senators Carper, Levin, Pryor, Tester, Baldwin, Heitkamp, Coburn, Johnson, and Ayotte.

OPENING STATEMENT OF CHAIRMAN CARPER

Chairman CARPER. The Committee will come to order. Welcome, everyone. We meet today for the third hearing that we have held this year to consider the financial challenges facing the Postal Service, and this is the second since Dr. Coburn and I put forth a comprehensive, bipartisan proposal to address those challenges.

As I mentioned at our hearing last week, one of my top goals since joining this Committee has been to not just help the Postal Service get by, but to help it become strong again and remain viable for the long term.

Despite my efforts, and despite the efforts of our predecessors on this Committee and those of Postal management, Postal employees, and others, we find ourselves closer than we have ever been to losing the vital services that the Postal Service offers to all of us. At risk as well are the approximately 8 million jobs that depend on its continued vitality.

The Postal Service has maxed out its credit line with the Treasury and is rapidly running out of cash. Despite an improving economy and some positive signals from some parts of its business, its immediate future is not bright. Absent legislative intervention, the Postal Service will likely limp along for a while unable to invest for the future, with its employees and customers uncertain of what that future holds. But it can only limp along for so long.

There is no single easy solution to this problem. It is a problem that has been years in the making and will take years still to fully address. But with urgent action from the Congress and the Administration, the collapse of the Postal Service is avoidable, and I would just say action from the Board of Governors (BOG), action from Postal management, and from the unions who represent the Post Office, and from the employees themselves. This is a shared responsibility, and we are certainly a big part of that responsibility.

Last week, my colleagues and I debated the tough decisions that will need to be made in the coming months and years regarding the level of service that the Postal Service should offer the American people. We also discussed how it should price and market its products. Most importantly, we heard about a number of innovative ways, really an encouraging number of innovative ways that the Postal Service can make itself relevant to a new generation of customers by taking creative advantage of its one-of-a-kind retail, processing, and delivery network.

Today our focus will be the Postal workforce and the steps that the Postal Service must take to make sure it has the right people with the right skills as it works to survive and thrive in the years to come. We will also touch on the financial obligations the Postal Service—and, by extension, the Treasury—has made to Postal employees and how those obligations should be funded.

At its peak in 1999, the Postal workforce totaled some 800,000 people. Today the Postal Service employs just under 500,000 men and women to service an ever-growing number of addresses across the country. This is possible due in part to the recent declines in mail volume, but also to automation and some hard work on the part of Postal management and the rank-and-file to make processing and delivering the mail more efficient. More must be done in this area, and the bill that Dr. Coburn and I have introduced we believe will help.

Our bill would also help end longstanding debates about how much the Postal Service owes the Treasury for its employees' pension and health care obligations, how much it should be paying to fund these obligations, and how aggressive its payment schedule should be.

On pensions, we would require the Office of Personnel Management (OPM) to use more accurate data on how Postal employees are paid and how much they actually draw down over their lifetimes from the Federal Employees Retirement System (FERS) and from the Civil Service Retirement System (CSRS). This reform would likely save the Postal Service billions of dollars over time. It would also show that the Postal Service has overpaid its obligations to the Federal Employees Retirement System, and result in a refund of as much as $6 billion.

On health care, we would end the extremely aggressive schedule put in place in 2006 to pay down the Postal Service's unfunded retiree health obligation, a schedule more aggressive than any I have ever seen in State or local governments, municipal governments, or, frankly, in the private sector.

That payment schedule was put in place for a noble purpose about 7 years ago. The goal was to make certain that a then-healthy Postal Service that faced an uncertain future due to the growth in electronic communications was putting away as much money as it could so that taxpayers would not be stuck with its health care bill. But the size of the payments have been crippling.

Our bill would create a more sensible and affordable schedule for paying down the vast majority of the Postal Service's long-term obligation over the next 40 years. It would also give the Postal Service access to the more than $40 billion in its retiree health account today to pay its growing costs related to premiums for current retirees.

These reforms alone would make the Postal Service's books dramatically better and free up cash that it can use to invest in innovation, its vehicle fleet, and other long-neglected needs. But the reforms in our bill intended to enable more efficient use of the Medicare benefits the Postal Service and its retirees have paid for have the potential to dramatically reduce its outstanding health care obligations and, as a result, its retiree health prefunding payments.

Finally, our bill would give the Postal Service and the unions representing the employees the authority that they need to have a full, a robust, and hopefully a productive conversation about the package of pay and benefits current and future Postal employees should receive. Unlike other proposals that have been made over the years, our proposal would not enable layoffs, would not abrogate union contracts. It would seek to ensure that anyone whose job might be displaced in one area would clearly have another place to go in the Postal Service, so that no one would actually in the end lose their jobs. The workforce would be reduced, continue to be reduced, but it would be done through attrition, and it would be done in a humane way.

We seek to require in our legislation, as I said, a conversation about tradeoffs between labor and management. This reflects the fact that it is not my goal and I do not think it is our goal to make Postal employees alone bear the price associated with fixing the Postal Service.

I have said there are three groups that I hope that we are mindful of as we legislate, that we are fair to, and they include customers, Postal customers, they include Postal employees, and they include taxpayers. Those are the three, for me the three key groups.

Before I turn to Dr. Coburn for his statement, I just want to thank him and his staff for working with us to be able to put together, after a long time and a lot of work, this bipartisan legislation. We know it is not perfect. We know it is not the finish line. But I think it is certainly well intended, I think a well-constructed compromise, and one that we seek to improve on as time goes by.

The Postal Service faces serious challenges. A lot of people are working very hard to overcome those challenges. We have been working very hard to be a good partner. This is a problem that can be fixed.

I will close with these words: I think one of the things that is missing right now to move our economy from a modest economic recovery to a robust economic recovery is concerns across this country, can we govern, can we be fiscally responsible as a country, can we provide certainty, particularly with respect to our Tax Code? Those are the three elements that nationally are needed to get our economy moving in an even stronger way. And I think when you have 7 or 8 million jobs that flow from the Postal Service, that depend on the Postal Service, we could do a whole lot in terms of helping the economy, boosting the economy, by providing the certainty that is missing and the certainty that is needed. We can fix this problem, and our goal, our challenge, is to do that with the help of a lot of people in this room and people who are listening to and watching this hearing today.

And now I am happy to turn to my colleague and my cosponsor on our legislation. Tom.

OPENING STATEMENT OF SENATOR COBURN

Senator COBURN. Thank you, Senator Carper.

Most of you know we put out this draft bill after working for a long period of time with a lot of the stakeholders, with the Postmaster General. But it is a draft bill, and this is one of multiple hearings that we are going to have on it.

But I would give this warning to everybody involved in this process: If you do not like what is in this bill and you want to solve the problem, you cannot just complain about what is in the bill. You have to come with an alternative solution that accomplishes the same goals.

So having said that, there are three options: One is the Post Office has to continue to be able to trim its costs in a way that is both ethical and proper; it has to figure out how to achieve greater revenues; and, finally, the third option—which is not an option—is to have the taxpayers of this country bail it out. It is not going to happen.

And so I am very appreciative of John Kilvington and Senator Carper and the rest of his staff in terms of working. I think we can be a model for compromise.

This bill is not finished. Everybody knows it is not finished. We are going to try to have a modified bill before we ever go to markup based on what we hear from these hearings and what we can accomplish. But it cannot be, "No." It has to be, "No, but here is a different solution." I hope that the people that testify today recognize that. We are going to solve this problem. We are going to get a bill. Tom and I are committed to forging a compromise that we can get through our Committee and we can get to the Senate floor. We are going to do that based on our personal relationship, but also recognizing the responsibility, as he said, to govern. We are going to do it. The fact that not anybody really likes the end product is probably the sweet spot of where we need to end up being.

So I want to thank him again. He is a good friend of mine. The word "friend" is used pretty cavalierly in the Senate and not sincerely. But Tom Carper is a friend of mine, and I am willing to make tough choices to make him successful and us successful in accomplishing that.

I yield back.

Chairman CARPER. Tom, thank you for those kind words.

We have been joined by Senator Pryor, Senator Johnson, and Senator Heitkamp. We welcome all of you. And with that, we are going to turn to our first panel of witnesses.

The first witness is a new face. We have not seen him here before. I think his name is Donahoe. But, Postmaster General, I am glad we do not have to pay you on a per appearance basis because the debt would be even greater.

Mr. Donahoe is the Postmaster General—he has his deputy right there behind him. Ron, it is nice to see you—but Postmaster General and Chief Executive Officer (CEO) at the Postal Service. Mr. Donahoe has spent his entire career at the Postal Service, beginning as a clerk in his hometown of Pittsburgh, Pennsylvania. He spent many years in top leadership positions before being appointed Postmaster General in 2010, 3 years ago. It must seem like three decades ago, but it has only been 3 years.

Our next witness is Jonathan Foley. Mr. Foley is Director of Planning and Policy Analysis at the U.S. Office of Personnel Management, where he is responsible for providing advice on a range of topics that include the Federal Employees Health Benefit Program (FEHBP). Before taking on his current position, Mr. Foley developed and implemented primary health care policy for the New Zealand Ministry of Health from 1999 to 2008. How we ever got you to leave New Zealand to come and take this job is beyond me, but we are glad you did.

Next is Frank Todisco, Chief Actuary at the U.S. Government Accountability Office (GAO). In that capacity Mr. Todisco serves as an adviser to the agency on major Federal programs and policies pertaining to retirement security, health care, and life and casualty insurance. Frank, it is good of you to join us. We are an admirer of the folks that you work with, you and your team, and very grateful for your help.

The final witness for this panel is John Dicken. Mr. Dicken serves as Director for Health Care Issues at the U.S. Government Accountability Office, where he leads the agency's assessments of private health insurance and prescription drug pricing issues.

We thank all of our witnesses for being here. Your entire testimonies will be made part of the record, and feel free to testify. We will set the clock at about 7 minutes. Try to stick to that if you can, and if you go way beyond it, we will have to bang the gavel.

So welcome, Postmaster General. You are up. Take it away. Thank you.

TESTIMONY OF THE HON. PATRICK R. DONAHOE,[1] POSTMASTER GENERAL AND CHIEF EXECUTIVE OFFICER, U.S. POSTAL SERVICE

Mr. DONAHOE. Thank you. Good morning, Mr. Chairman, Dr. Coburn, Members of the Committee. Thank you, Mr. Chairman, for calling this hearing.

There is a fundamental question to be answered about the future of the Postal Service, and it is this: Will the Postal Service be given the authority and flexibility that enables it to continue as a self-funding entity?

I believe everyone wants that answer to be yes. The Postal Service can be profitable and pay down its debt. It can continue to provide secure, affordable, and reliable universal service. It can continue to meet the needs of rural America. It can continue to drive economic growth. It can continue to be a responsible employer and a great place to work. And if given flexibility and authority to adapt in a changing world, it can meet all of these goals without becoming a burden to the American taxpayer.

[1] The prepared statement of Mr. Donahoe appears in the Appendix on page 451.

The choice is simple: greater flexibility and authority now or massive taxpayer exposure and service degradation later.

The Postal reform bill of 2013, S. 1486, goes a long way toward putting us on the path to financial stability. It provides flexibility and authority in many critical areas, and most importantly, it acknowledges our primary challenge: The related issues of health care benefits and the need to prefund liabilities.

As currently written, the bill would provide significant savings, but as both you, Mr. Chairman, and you, Dr. Coburn, have noted, it remains a work in progress. Working together with all stakeholders and by including stronger language regarding Medicare integration and health care costs, Senate bill 1486 can accomplish the goal that we all share.

As the Committee knows, we are seeking additional authority under the law to control our health care costs. We want to negotiate better and more cost-efficient health care coverage for our employees and retirees and ensure better integration with Medicare. If we do so, we can virtually eliminate our unfunded liability for retiree health care benefits. We can also reduce the amount that we will need to set aside for retirees in the future to an amount that we can manage. This in turn will secure lifetime coverage for all of our retirees. It will maintain choices for our employees and retirees, and it will immediately reduce our health care cost burden from 20 cents out of every revenue dollar that we bring in to just 8 cents. This is a savings of approximately $8 billion a year through the year 2016 compared to our current expenses.

Today the Postal Service and its employees are paying for benefits we do not use. We are effectively buying insurance we do not need, and we are overpaying for it. Both the Postal Service and our retirees have paid $27 billion into Medicare, yet many do not draw the benefits that they are entitled to. And so we are obligated to overpay to compensate for this fact.

Under the current law, the Postal Service and its retirees pay full freight into insurance companies within the FEHB system. Instead, our retirees should be using Medicare A, B, and D as their base coverage. Under this vastly preferable scenario, the Postal Service and our retirees would merely need to fund far less costly benefits wrapped around Medicare coverage.

This is more than just a budgeting issue. This is an issue of fairness. It is fundamentally unfair to ask our employees and retirees, and ultimately our ratepayers and potentially taxpayers, to continue to needlessly overpay into health care insurance.

In simple terms, we are merely asking to be able to manage our retiree health care not by reducing benefits, like many other employers that we hear about today, but by wrap-around supplementary plans around Medicare. This will allow us to maintain current levels of coverage, generate annual savings for both the Postal Service, our employees, and our retirees, and we can do this simply by eliminating unwanted overpayments.

Does the Postal Service have an obligation to employees and retirees to provide health care insurance for decades to come? Of course it does. And the best way to meet that obligation is to create a program that is financially stable in the long term.

Our proposal accomplishes that goal. We have developed our plan with leading experts in the field, which is essentially the approach that nearly every other company takes and one that the GAO has supported. If we are allowed to negotiate our own health care plan, either within or outside of the FEHB Program, the Postal Service will be able to provide the same or better coverage at a much lower cost for the vast majority of our employees and our retirees.

I cannot overstate how important it is for the Postal Service to have its own health care plan or to have a health care plan through FEHB with the OPM, work with us to negotiate a new integrated plan that gives us choices specifically for the Postal Service within the FEHB.

We want to work with this Committee to establish an effective and sustainable health care program for our employees and retirees. We want Senate bill 1486 to include clear mandates for the Postal Service, the FEHB, and OPM to make this happen.

Mr. Chairman, by taking this approach, the Postal Service can reduce annual costs by up to $8 billion a year annually through 2016. This goes a long way to closing the projected budget gap that will exist in 2016 of $20 billion, if we do not take action.

Yesterday the Postal Service announced a price increase above the rate of inflation. We did not want to take this step, but we have little choice due to our current financial condition. Resolving health care issues will mitigate the pressures to raise prices and take other unpalatable steps in the future, but we must fully address our health care costs in order to do so.

I would like to thank the Committee for taking up Postal reform legislation this year and holding this important hearing again today. I look forward to answering your questions and supporting your work in any way that I can.

This concludes my remarks. Thank you.

Chairman CARPER. Thank you, General Donahoe.

Mr. Foley, please proceed.

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

Mr. FOLEY. Chairman Carper, Ranking Member Coburn, and Members of the Committee, thank you for the opportunity to testify regarding reform of the U.S. Postal Service, including changes to employee benefits. As program administrator for the Federal Employees Health Benefits Program, Civil Service Retirement System, the Federal Employees Retirement System, and fiduciary for the health and pension trust funds underpinning these programs, OPM has an interest in reforming the benefits available to the Postal Service workforce.

The Postal Accountability and Enhancement Act (PAEA) of 2006 required the Postal Service to prefund retiree health benefits to cover the Postal Service's liability for the health care costs of current and future retirees under the FEHB Program. Due to its financial difficulties, the Postal Service was unable to make the required fixed payments due in fiscal years 2011 and 2012. OPM cal-

[1] The prepared statement of Mr. Foley appears in the Appendix on page 471.

culates the actuarial liability at $94 billion as of September 30, 2012. Subtracting the fund value of $46 billion, there remains an unfunded liability of about $48 billion.

With respect to retirement benefits, Postal Service contributions to FERS total approximately $3 billion per year. These expenses are incurred only on behalf of those employees enrolled in FERS. The FERS funding and employee cost-sharing requirements are the same as those that apply to all non-postal agencies and employees.

The President's Fiscal Year (FY) 2014 budget includes short-term relief and long-term reforms to the Postal Service, including a proposal allowing OPM to calculate the Postal Service's share of its FERS costs using postal-specific demographic assumptions. In the proposal, the amount of any postal FERS actuarial funding surplus as most recently computed according to governmentwide actuarial assumptions would be refunded to the Postal Service in 2013, and any remaining amounts would be refunded in 2014 and 2015 after OPM has completed a demographic study of Postal Service data to determine a postal-specific normal cost.

The Postal Reform Act of 2013 would authorize the Postal Service to negotiate retirement benefit terms for new employees and to create new health benefit plans which may be offered within the FEHB Program.

Section 102 of the legislation would grant labor organizations and the Postal Service the authority to negotiate retirement benefits for employees. OPM is concerned that the ability to negotiate retirement benefits, especially whether an employee is covered in FERS, will result in disparate execution of benefits. Tracking and reporting variable employee deduction rates based on bargaining unit and time period would be immensely time-consuming and costly, resulting in delays in retirement claims processing for all agencies.

Additionally, OPM has technical concerns with Section 102(a)(1). Employee retirement contributions to the Civil Service Retirement and Disability Fund resulting from negotiated agreements require clarification. OPM would like to work with the Committee to address these technical concerns.

Section 104 would authorize the Postal Service to enter into individual or joint collective bargaining agreements with bargaining representatives to create a single Postal Service Health Benefits Plan. The Postal Service and its employees and retirees are well served by the FEHB Program. OPM's overhead costs for the FEHB Program are only 0.08 percent of total premiums. These very low overhead costs have been achieved by the accumulated experience of the agency and its staff having managed these programs for decades. In addition, annual premium increases for FEHB plans are typically at or below industry averages. In fact, the average growth in FEHB premiums has been below 4 percent for each of the last 3 years.

A withdrawal of Postal employees and actives would have a particular impact on health plans with a large postal population. Postal Service employees and retirees represent more than 50 percent of the enrolled population in 23 FEHB plans. If these plans were to choose to withdraw from the FEHB Program, their remaining non-postal members, approximately 90,000 people, would need to choose another plan.

Section 104 could also have the effect of eliminating retiree health coverage for employees who become enrollees in the Postal Health Plan that is outside of Chapter 89. These enrollees would not be able to carry FEHB into retirement, and the Postal Health Plan would not extend health insurance coverage to retirees. If this is not the intent of Congress, OPM could provide technical assistance to address this matter.

Section 105 would remove postal actives and annuitants with both Medicare Parts A and B from the FEHB risk pool and create separate FEHBP enrollment options for health benefit plans with a separate risk pool for these individual and family members covered by Medicare Parts A and B. Postal annuitants without Medicare coverage, with Medicare Part A only, or Medicare Part B only, would be the only postal groups to remain in the original FEHB Program risk pool. Because the groups to be removed are less expensive than those employees and retirees that are to remain, we anticipate this change will result in an increased cost to the FEHB Program on a per enrollee basis. If Postal employees and retirees are removed from the FEHB Program risk pool under both Sections 104 and 105, costs under the original FEHB Program risk pool would increase by about 2 percent per enrollee. However, the impact on premiums from individual plans with high concentrations of postal enrollees would be considerably greater.

Any effort to return the Postal Service to financial sustainability requires careful analysis in order to avoid unintended consequences. We look forward to working with the Committee to assist the Postal Service in addressing its fiscal challenges.

Chairman CARPER. Mr. Foley, thanks so much for that testimony.

Mr. Todisco, you are recognized. Please proceed.

TESTIMONY OF FRANK TODISCO,[1] CHIEF ACTUARY, APPLIED RESEARCH AND METHODS, AND JOHN E. DICKEN, DIRECTOR, HEALTH CARE, U.S. GOVERNMENT ACCOUNTABILITY OFFICE

Mr. TODISCO. Thank you, Chairman Carper, Ranking Member Coburn, Members of the Committee. I will be making a single statement on behalf of GAO, and then Mr. Dicken and I will both be available to answer questions.

Thanks for the opportunity to testify today on Postal Service pension and health care benefit issues. As shown in Table 1 of our written testimony, the Postal Service had $96 billion in unfunded benefits and other liabilities at the end of fiscal year 2012. These liabilities have become a large and growing financial burden, and the Postal Service's financial condition will make paying for them highly challenging.

Our testimony focuses on our work on three particular benefit issues: Funding Postal Service retiree health benefits, the Postal Service's proposal to establish its own health plan outside of the

[1] The prepared statement of Mr. Todisco appears in the Appendix on page 475.

Federal employees health care program, and the treatment of potential surpluses under the Federal Employees Retirement System.

First, funding retiree health benefits. We reported last December that Congress needs to modify the Postal Service's retiree health prefunding payments in a fiscally responsible manner. We noted that the payment schedule under current law is significantly front-loaded, with payment requirements through 2016 that are well in excess of the actuarially determined amounts. We have also stated that the Postal Service should prefund any unfunded retiree health benefit liabilities to the maximum extent that its finances permit.

One reason for prefunding is to protect the Postal Service's long-term viability by paying for retirement benefits as they are being earned. To the extent prefunding is postponed, larger payments will be required later when they likely would be supported by less first-class mail volume.

Fully funded benefits also make promised benefits more secure. However, the Postal Service currently lacks liquidity, and no prefunding approach will be viable unless the Postal Service can make the required payments.

We have raised concerns about proposals to lower the funding target from 100 percent to 80 percent. An 80-percent funding target would lead to a permanent unfunded liability of roughly 20 percent, which would mean about a $19 billion unfunded liability at today's level.

Next, the Postal Service's proposed health care plan. GAO recently reported that the Postal Service would likely realize large financial gains from its proposal to establish its own health plan outside of the Federal employees health care program, FEHBP. The Postal Service's proposed plan is designed to increase postal retirees' enrollment in Medicare as well as take advantage of Medicare's subsidies for employer-based prescription drug plans.

Of the nearly $55 billion the Postal Service projects in reduced health benefits liability from this proposal, nearly $49 billion is related to fuller coordination with Medicare. The withdrawal of all of the nearly 1 million postal enrollees from FEHBP would represent about a 25-percent decrease in FEHBP enrollment. Nonetheless, most remaining non-postal enrollees would likely not be significantly affected by a Postal Service withdrawal.

Note that the Postal Service has recently discussed the possibility of a new postal health program that would be offered within FEHBP, whereas we analyzed the prior proposal to go outside of FEHBP. Further, if Postal enrollees were allowed to voluntarily select whether or not to participate in new postal plans within FEHBP, the impact on Postal Service savings and on FEHBP premiums could vary from prior estimates.

As Congress considers proposals for a Postal Service health care plan, it should weigh the impact on Medicare, which also faces fiscal pressure. Other important issues include safeguards for plan assets, which would include the almost $50 billion of retiree health assets, and protections for plan participants comparable to those in the Federal health program.

Last, treatment of FERS pension surpluses. We have reported on several key considerations regarding the release of any FERS pension surplus to the Postal Service.

First, it is important to note that estimates of retirement benefit liabilities contain a high degree of uncertainty and can change over time.

Second, regarding the proposal to use postal-specific actuarial assumptions rather than governmentwide assumptions to measure the Postal Service's liability, we support using the most accurate assumptions possible, subject to such assumptions being recommended by an independent body.

Third, we have pointed out that a release of the entire surplus could be considered as a special one-time action as part of a larger package of reforms, but that returning surpluses whenever they developed would likely eventually result in an unfunded liability. We have suggested alternative formulas that could be used to address any future surpluses.

Finally, any decisions on the FERS surplus should be made cognizant of the Postal Service's various other unfunded liabilities.

In closing, GAO continues to believe that a comprehensive package of legislative actions is needed so that the Postal Service can achieve both short-term and long-term financial viability and ensure adequate benefits funding for more than 1 million postal employees and retirees.

This concludes our prepared remarks. We would be happy to answer any questions.

Chairman CARPER. Mr. Todisco, thanks so much. Our thanks again to all of you. Very constructive testimony, and we want to dig into it, but let me just, if I could, sort of set the playing field and go back a week ago to our previous hearing. One of the things we talked about at that time was rightsizing this enterprise. Much as the auto industry has rightsized itself over the last half dozen or so years. What the Postal Service is attempting to do is to rightsize the enterprise, and we are trying to not be an impediment but actually to help you do that.

If you go back a dozen or so years ago, the workforce, I think as the Postmaster General said, was about 800,000 people. Today it is just under 500,000. If you go back about half a dozen years ago, my recollection is that the number of postal processing plants in our country was about 600. We are now down to roughly 300, 325.

Among the most encouraging things that I heard last week at our hearing—I do not know about Tom and the others that were there, but when you, Mr. Postmaster General, and other witnesses talked about how do we take what is unique about the Postal Service's one-of-a-kind distribution system that goes to every mailbox in the country at least 5 or 6 days a week, how do we take that legacy distribution center and find new ways to make money out of it in a digital age? And I thought the ideas that came forward were just very encouraging. This cannot be just about cut, cut, cut. This has to be about how do we innovate and find new ways to make revenues, and I think there are some great ideas out there. And some of them are already being implemented.

Before we leave here today, I just hope that we develop a clearer understanding amongst ourselves and with our witnesses on two or three key points.

One is the issue of is it fair, is it appropriate, is it equitable for the Postal Service to continue to pay into Medicare and to overpay into retirement for its employees? We know the Medicare trust fund is not in good shape, but is it fair to ask the Postal Service and its employees to continue to pay into a Medicare system where they are not actually getting the full benefits from it? Is that fair?

Second, is it fair for the Postal Service—well, let me just back up. There are two retirement systems, we know, into which the Postal Service and employees have paid: The Civil Service Retirement System, the oldest and the Federal Employee Retirement System which most of the people who work for the Postal Service pay into. When I introduced legislation, gosh, almost 3 years ago, at the beginning of the last Congress, on postal reform, I actually said it looks like the Postal Service has not only overpaid its obligation to the Federal Employee Retirement System, the newer system, but maybe as much as $50 billion or $75 billion into the old system. And I thought, boy, this is going to make solving this problem easy. We will just get that money back from the Civil Service Retirement System, and we will be off to the races.

Well, it was not that easy. And as it turns out, there are a lot of folks who did not believe that there had been that overpayment into the Civil Service Retirement System, and they included OPM, they included the Office of Management and Budget (OMB), they included the Administration, they included GAO. So, frankly, some of the key people that we looked to help us make those decisions said, no, not the case.

There is, however, agreement that there has been an overpayment in the Federal Employee Retirement System, and it appears to be that there is going to continue to be an overpayment going forward because of the actuarial assumptions that we use for Postal employees. And, one, we have the opportunity, I think the obligation, to try to take some of that overpayment into FERS and return it to the Postal Service, not to spend. What I think the Board of Governors wants to do is to pay down its obligation to the Treasury, some of it at least.

The other question is: What do we do about making sure going forward we do not continue to have that overpayment into FERS? I think the bill that Dr. Coburn and I have introduced seeks to address both of those in a fair and equitable way.

The other thing, a long time ago when I was elected State Treasurer, we had no cash management system in Delaware. We could not balance our budget if our lives depended on it. We were a mess. And one of the things we set to work—Pete du Pont was our Governor, and we went to work trying to salvage the cash management system, to establish a pension fund, and to amortize that over 40 years. We did it in 10 years—not 40 but in 10 years. And in my last term as Governor, I was up meeting with the folks at the rating agencies—Moody's, Standard and Poors (S&P), Fitch—and they said, "You guys have done a pretty good job on your finances," and they were about to raise us to AAA. But they said, "There is one thing you have not done." And I said, "What is that?" And they said, "You have not done anything to prepare for paying the health care costs of your retirees." That is what they said: "You have not done anything."

So we went to work on that. We are still working on that. And we will be working on that in Delaware for a number of years.

Well, we have an obligation, the Postal Service has a real obligation to set aside money for paying the retiree health care benefits. And the question is: How do we do it?

The 2006 legislation said basically let us do it in 10 years. I do not know of anybody, any business, any company, any level of government, that has that kind of obligation. It is just not responsible.

What Dr. Coburn and I have said is this: It is almost like a 40-year mortgage. There is this obligation, let us pay it. Let us make sure it is going to be paid. Let us do it over 40 years, not ignore it, not do it over 10 years, 20 years, or 30 years. Let us do it over 40 years.

Also, there is this question of money that has been set aside, the $40 billion that has already been paid. What do we do with that? And what we propose to do in our legislation is allow the Postal Service to use that money in the meantime to help meet the obligation to provide health care for its retirees.

The last thing I want to say is this: I want to turn to GAO on this. I want to ask about the fairness, the equity of the Postal Service continuing to overpay into FERS but, most importantly, really paying twice for the health care, including overpayments into Medicare, for benefits that, frankly, they are not going to use.

Would you talk to us about the fairness of that and what we ought to do? Thank you.

Mr. TODISCO. Well, I will talk first about FERS, and then Mr. Dicken will talk about the Medicare issue.

It is in the nature of a defined benefit plan, which FERS is, that the future benefit payments are uncertain. We do not know how long people will live. We make estimates about that, when they will retire, et cetera. So it is an uncertain measure, the liability. It is going to change from year to year. And when you are close to 100 percent funding, which the Postal Service is for their FERS obligation, small changes in the liabilities up or down could put you into a surplus 1 year, a deficit the next year.

That said, the estimates that are out there now seem to indicate that with revised assumptions, using postal-specific assumptions, there will be a bigger surplus than previously measured. And we have said returning that as part of a package of reforms could make some sense.

But going forward, you talked, Mr. Chairman, about how to avoid surpluses in the future in FERS, and it is impossible to avoid surpluses or deficits completely, and you want to keep them small, and a way to do that is to stay with a fully funded target, and as you deviate from that a little bit from year to year, you amortize those gains or losses over some reasonable period of time, and you just keep heading toward that moving target.

Chairman CARPER. Go ahead, Mr. Dicken.

Mr. DICKEN. Regarding Medicare, indeed, the Postal Service and its employees have paid taxes that would be for the Medicare Part A and Part B. And, indeed, more than three-fourths of Medicare-eligible Postal Service retirees have used Medicare Part A and B. The remainder, because they have paid those taxes, would be eligible if they have the 40 quarters of tax payments, but would also require for Part B that the retirees pay their share of the Medicare Part B premiums to get that coverage.

About half the savings that the Postal Service estimates from their plan also come from coordination with the drug benefit in Medicare Part D, and as you know, that is funded differently and through not so much the taxes that have been paid but through other premium payments that would need to be made.

Chairman CARPER. OK. My time has expired on this round. I want to come back and drill down on this some more, Postmaster General and Mr. Foley, if you will.

I will just close, before turning it over to Tom. My wife, as I said to some of you before, my wife retired from DuPont. When she turns 65—in about another 30 years—she will be eligible for Medicare, and they expect her to use it. They expect her to use it. They will provide a wrap-around plan. And it is not just DuPont that does this. It is just about every company of any consequence in this country. And the question is: Should the Postal Service be treated differently, should its employees be treated differently? And we do not believe so. Dr. Coburn.

Senator COBURN. Mr. Dicken, let me ask you, was it your testimony just now that three-quarters of retired postal employees utilize Medicare A and B?

Mr. DICKEN. Right. Of those participating in FEHBP that are Medicare eligible, three-fourths have also enrolled in——

Senator COBURN. So they are buying a Medicare wrap-around plan now.

Mr. DICKEN. They are buying——

Senator COBURN. Three-quarters of them are.

Mr. DICKEN. That Medicare would become the primary payer for those if they are retired. FEHBP then would be the secondary payer.

Senator COBURN. So only one-quarter of retired postal workers are not using Medicare.

Mr. DICKEN. What we have is that 77 percent have enrolled in Part A and B. Others have enrolled either in neither or only Part A or Part B.

Senator COBURN. OK, but those are good numbers that we have, 77 percent are in A and B. That is a big fact we were not aware of. Thank you.

Mr. Foley, I wanted to ask you a question. Based on your statement just a minute ago, it would seem to me right now that the Postal employees are subsidizing the rest of the Federal employees through FEHBP, because if you take backward what you said, a 2-percent differential, either their costs are less or they are paying more. So basically Postal employees in this country are subsidizing the rest of the Federal employees. Is that an accurate assumption based on your testimony?

Mr. FOLEY. The nature of a risk pool that includes a lot of diverse employees and annuitants with different circumstances, the nature of the risk pool is such that there are gives and takes in terms of the costs per enrollee. And so if you remove a population—as I said in the testimony, a population that costs less than Medicare A and B covered individuals, it will increase the costs of those who remain in the pool.

Senator COBURN. So the inverse is that postal employees today are presently subsidizing the rest of the Federal workforce, if that, in fact, is the case. If you pull them out and they are a lower-cost segment, you will see a resultant increase in the rest, because they are a lower-cost segment but they are paying the same. So they are in essence—and this is a key point for our Committee—Postal employees today are subsidizing the rest of the Federal workforce. And that is part of our problem, and that is part of the point that the Postmaster General has been making is that he can get a better package, a better deal, either in FEHBP or out, that will give—and here is the point: Senator Carper and I agree on a lot of things in this bill. We do not want the first Postal employee to see a change in the real benefit that they are getting. The question is: Can the Postal Service and can the employee get exactly the same benefit at a lower cost to the Postal Service? And your testimony, even though there are problems in executing this, as you outlined, would say that is true, because you just said 2 percent—at a minimum a 2-percent pop for everybody else, and this only represents a quarter of FEHBP, which implies a 6- to 7-percent subsidy by Postal employees for the rest of the Federal workers. I think that is an important note that we need to act on, and as far as being part of whatever we end up doing, is to recognize that disparity in our negotiations.

I need two unanimous consents. Dr. Rick Geddes from Cornell has submitted testimony for our hearing, and I would like to submit that at this time.[1]

Chairman CARPER. Without objection.

Senator COBURN. And I would also like to put in a comparison from USA Today and also work my staff has done on average salary and benefits within the Postal Service by bargaining unit,[2] and also nationally Federal, State and local, and private, and the comparisons, because the reason I want to put this into the record is if you look at the private sector, the benefits per employee average $10,589. At the State and local government level, it is $16,857. At the Federal level, it is $41,791. And that is a significant fact we need to bear in mind as we ask the Postal Service to be competitive, to be able to continue to deliver the magazines, the flats, the catalogues, and not have to raise those prices. We have to give them the capability to handle those costs in a more efficient way. So I would ask unanimous consent for both those things.

Chairman CARPER. Without objection.

Senator COBURN. Mr. Todisco, your testimony shows that Federal workers' compensation liabilities have grown from $7.7 billion in 2007 to $17.6 billion in 2012, and these liabilities, as I understand it, do not include Postal workers yet to be added to the program. Is that correct?

Mr. TODISCO. That is correct.

Senator COBURN. Do you think the Postal Service should prefund its workers' compensation obligations?

Mr. TODISCO. That is a policy decision. The Postal Service would be better off if those were prefunded. We recognize that there are not the funds right now to do that given the other unfunded obligations, including the retiree medical unfunded liability and the debt

[1] Statement for the Record from Dr. Geddes appears in the Appendix on page 544.
[2] Statement for the Record from USA Today appears in the Appendix on page 551.

to Treasury. But it would enhance the long-term viability of the Postal Service if those benefits were funded.

Senator COBURN. All right. In your testimony on the FERS overpayment, can you see a way that would address your concerns of this swing if we were to do something rather than just take overpayment, take the average 3-year rolling average of what that was, would that seem to be a more sensible way to address what the actual overpayment is so that we do not overshoot? What would you think about that?

Mr. TODISCO. Well, there is a policy decision about whether to do a one-time return of surplus, but aside from that issue, going forward, it does make sense to do some kind of smoothing as to how you react to those measurements from year to year.

Under current law, when there is a deficit, that is amortized over 30 years. The annual payment is increased just to fund that over 30 years. When there is a surplus under current law, the Postal Service gets no financial benefit from that. That is an unfair asymmetry in current law which——

Senator COBURN. For the Postal Service.

Mr. TODISCO. For the Postal Service that we have recommended fixing.

Senator COBURN. All right. Thank you. My time is up.

Chairman CARPER. Senator Pryor. Senator Pryor slipped out. Senator Heitkamp, welcome.

OPENING STATEMENT OF SENATOR HEITKAMP

Senator HEITKAMP. Thank you, Mr. Chairman. I just have a couple questions because I am mainly here to try and understand kind of a path forward. And, obviously, Mr. Foley and the other gentlemen are here representing and concerned about a plan, but we are concerned about the viability and the future of the United States Post Office. And a big part of that is exactly the discussion that Dr. Coburn just had with you, which is, we have to be able to pay our bills. We cannot be in the position of subsidizing other systems or having demands that competitors do not have in terms of your cost/benefit. And so it is with a great deal of sympathy that I have for the Postal Service in terms of the dilemma that they are in. So I just have a couple probably more technical questions.

First, Mr. Foley, can you share OPM's analysis of the impacts of these provisions on the remaining FEHB? Your testimony indicated that costs would increase about 2 percent for the original program risk pool once the Postal employees and retirees are moved out, which I think we have discussed a little bit with Dr. Coburn. And I know that there was some debate last year on the very similar plan that some carriers might, in fact, see premium increases as high as 35 percent.

What type of impact do you expect on those who would remain within the system?

Mr. FOLEY. As I said, the overall impact is 2 percent, but the impact varies by plan. So if there is a large concentration of Postal employees and annuitants in a plan and they are removed, then it is likely that the premiums for that particular plan will increase.

There are, as I said, 23 plans where over 50 percent of their enrollees are annuitants, Postal annuitants, and employees. There is a wide range in terms of the premium impact for those individual plans. They tend to be between 10 and 20 percent for those plans, but there are some——

Senator HEITKAMP. This is always the danger of average, right?

Mr. FOLEY. Right, and there are some that are higher. Those are among the 23 plans with the high concentration. FEHBP is fortunate to have a large number of plans, so as you see, the 2 percent is reflective of that large group of plans.

Senator HEITKAMP. Also in your testimony, you mentioned significant concerns regarding the ability to administer retirement benefits if the post office is able to negotiate retirement benefits and create groups of employees with different benefits and deduction rates. You say that the claims processing for all agencies would be negatively impacted by the burden.

Can you provide additional detail on that impact and how other Federal employees would be potentially harmed by this effort?

Mr. FOLEY. The potential exists through this bargaining to come up with differential arrangements for different bargaining units, and the difficulty we have with that is that is not something that is part of the current system. So it requires developing a whole new way of measuring employee service time and reflecting that accurately in pensions. And so that is a burden actually on the Postal Service as well as on OPM to track that accurately and to make sure that we are making the proper pension payments. So it introduces complexity into an already complex system where there are a number of different arrangements depending on the employee's status. So for us, that will have an impact on the overall claims processing system because of the complexity of those particular arrangements.

Senator HEITKAMP. But you certainly can appreciate how dealing with this in a kind of broader context and designing new systems would create problems not only administratively but also huge uncertainties for the retirees and for the near retirees that are looking at these plans.

Mr. FOLEY. We are happy to work with the Postal Service and the Committee to try to address those administrative concerns. We just feel obliged to point out that in an already stressed system, this puts further stress on that system.

Senator HEITKAMP. Right. I have a question for Mr. Todisco. In the Postmaster's testimony, he indicated his belief that better integrating Medicare with retiree health benefits, the post office would be able to virtually eliminate the need for its prefunding requirement. GAO has done significant research on this topic of the health plan proposal. Does the research at GAO indicate that the Postmaster is correct in terms of his assumptions?

Mr. TODISCO. Yes, with a clarification, if I may. The current liability is $94 billion; the assets are $46 billion; the unfunded is $48 billion. The estimate of the Postal Service's proposal to go outside of FEHBP, it would reduce that liability by $55 billion, thereby eliminating the unfunded. The liability would now be less than the assets already in the plan.

There would still need to be prefunding going forward because the liability does grow over time as workers accrue additional benefits. And under the Postal Service's own proposal, they would propose to prefund going forward, but it would require a much smaller level of payment than under the current situation.

Senator HEITKAMP. And I am just trying to kind of get a handle around these numbers. That is even with the 77 percent number that Mr. Dicken reported, those same savings. I mean, you have taken all that into consideration.

Mr. TODISCO. Right. Just adding on the other 23 percent and integrating—and adding in Medicare Part D, you get that amount of savings.

Senator HEITKAMP. OK. Thank you.

Chairman CARPER. Dr. Coburn, did you want to interject something?

Senator COBURN. Just a followup on Senator Heitkamp's discussion. If, in fact, FEHBP created separate plans inside FEHBP for the Postal Service, would your concerns, the administrative concerns, and the complexity be markedly decreased?

Mr. FOLEY. Our preference is to work with the Postal Service inside the FEHBP and to do reforms both on the employee side and the retiree side.

Senator COBURN. But you would testify that your concerns would be much alleviated if it was inside versus outside.

Mr. FOLEY. Yes.

Senator COBURN. The problems that your testimony gives, that is as if they go outside of FEHBP. Is that correct?

Mr. FOLEY. That is correct. I will just point out and feel obliged to point out that, a lot of this has to do with the impact on Medicare, and so really there is a conversation with the Centers for Medicare and Medicaid Services (CMS) that needs to be brought into this. But speaking from the FEHB perspective, we are happy to work with the Postal Service on new benefit designs within the FEHB.

Senator COBURN. All right. Thank you very much.

Chairman CARPER. OK. Let me just run through the order that we have. Senator Johnson is next, then Senator Baldwin; after Senator Baldwin, Senator Ayotte. Senator Tester has joined us and Senator Levin has joined us.

Senator Johnson, you are next, and then, Tammy. Go ahead.

OPENING STATEMENT OF SENATOR JOHNSON

Senator JOHNSON. Thank you, Mr. Chairman.

Mr. Todisco, let us define "unfunded liability." My understanding of that is it is basically the amount of money you need in the bank today to fund future benefits. Correct?

Mr. TODISCO. That is correct.

Senator JOHNSON. What is the discount rate you have used in calculating that $96 billion in your Table 1 on page 2 of your testimony?

Mr. TODISCO. That discount rate is actually selected by OPM, and I think it is 4.7 or—it is roughly in the 5-percent zone, but I do not have the——

Mr. FOLEY. That is correct.

Mr. TODISCO. Thank you.

Senator JOHNSON. So, again, you would be assuming you would have to make a 5-percent return on those invested funds in order to fund the future benefits. Correct?

Mr. TODISCO. That is correct, yes.

Senator JOHNSON. Are there any investments right now that are guaranteeing 5 percent long term?

Mr. TODISCO. No, there is not.

Senator JOHNSON. Pretty tough. So, in other words, with a lower investment rate, that unfunded liability would be actually higher.

Mr. TODISCO. That is correct, yes.

Senator JOHNSON. And there is really no difference between unfunded liability and liability. It is just a liability that you have to pay sometime in the future.

Mr. TODISCO. Well——

Senator JOHNSON. I mean, there is really very little difference.

Mr. TODISCO. Well, there is the liability. When there are assets supporting the liability, then the difference between the two becomes the——

Senator JOHNSON. Right, correct, OK. I keep hearing that the retirement system, the health care system, has been overfunded improperly. Now, as I am looking at your Table 1 here, what I am seeing is basically a $99 billion unfunded liability reduced by a $3 billion surplus in the FERS system. It does not look like there is anything that has been overfunded, I mean, other than you just segregate these little funds. And because of the calculation uncertainty of the discount rate, I do not see anything being overfunded in this fund. Is that an accurate assessment?

Mr. TODISCO. It is accurate. Out of the five different items we have in that table, the FERS piece is overfunded, but the other——

Senator JOHNSON. So, again, explain to me, because I hear all kinds of complaints that we have just unfairly made the postal workers overfund their pension liabilities and their health care. What are they talking about there? I have never understood that.

Mr. TODISCO. Well, there are different arguments with respect to different programs. With regard to FERS, the argument is that there is a surplus there; further, that the surplus, if remeasured using postal-specific assumptions, would be even bigger. And so the argument there is that the FERS——

Senator JOHNSON. But, again, that surplus could be wiped away by a different assumption in terms of the discount rate.

Mr. TODISCO. That is correct.

Senator JOHNSON. And easily wiped away by just a little tweak in the discount rate, quite honestly. So there is really no overfunding that you can really put any kind of confidence in whatsoever. It could be just as easily way underfunded based on your discount rate assumption.

Mr. TODISCO. Well, as we have said, those liability numbers have a high degree of uncertainty.

Senator JOHNSON. Correct. OK. If we go to a different type of health care plan, as is being proposed, the testimony is the postal system would save $55 billion, $49 billion of that apparently coming at the expense of Medicare. But, again, now we just heard testimony that 77 percent of Postal workers are already in Medicare.

Did that $49 billion take into account the fact that 77 percent of postal workers already are taking advantage of Medicare benefits?

Mr. DONAHOE. Yes, it does, if they are in Part A and B. Right now they are not using the drug benefit in Medicare, so that is not currently being used.

Senator JOHNSON. OK. So, again, if we are taking a look—I was kind of like consolidating the books of the Federal Government here, so you might be saving $55 billion for the Postal Service, but you are increasing the liability to Medicare and some other parts of the Federal Government by $55 billion. Correct? I mean, we are really just robbing Peter to pay Paul. Or am I missing something here?

Mr. DONAHOE. We certainly report that the largest share of that, $49 billion out of that $55 billion, is related to Medicare integration. Much of that is from the Medicare program. Some of that is also premiums for Part B by retirees that would be enrolling, and some of it would be discounts from drug manufacturers that are flowing——

Senator JOHNSON. And the remaining $6 billion would probably be the reduction in costs to the Postal system primarily because you have different actuarial postal-specific assumptions, so it adds that kind of 2-percent differential of Postal workers inside the FEHB. Correct.

Mr. DONAHOE. No. I would like to clarify, if I could—maybe to put a little light on this. The differential, what causes the overfunding, is the fact that when we do not integrate Medicare, we, in fact, pay more for health benefits. The average health benefit cost for a Federal retiree that is 65 years old, including a Postal retiree, is about $7,000 a year. The Postal Service pays 70 percent, the retiree pays 30 percent. In the private sector, a wrap-around plan averages somewhere between $4,000 to $4,500 a year. If we did that same math, we pay 70 percent, the employee/retiree pays 30 compensation, there is a differential.

When you take that and amortize that with a million people over the lifetime of those people, that is where the big overfunding is. What we are asking for, Senator, is to be able to be treated just like anybody else. We are the second largest payer into Medicare. We would just like to have integration of Medicare A, B, and D paid just like everybody else. That eliminates the $55 billion of overfunding.

Senator JOHNSON. There are certainly private sector companies that provide retiree health benefits. Correct?

Mr. DONAHOE. There are not as many as you would think.

Senator JOHNSON. But there are some.

Mr. DONAHOE. There are.

Senator JOHNSON. So it would certainly be different treatment because those individuals are also paying into Medicare——

Mr. DONAHOE. Which we are.

Senator JOHNSON [continuing]. Throughout their working life, and then they get employer-provided retiree health benefits.

Mr. DONAHOE. Which we do.

Senator JOHNSON. But we are not recommending in this piece of legislation to reimburse their Medicare payments, are we?

Mr. DONAHOE. No. What we are saying—here is what happens. What we are saying is reamortize the amount of money based on the differential in a wrap-around plan versus the full benefit plan that we have to pay OPM. OPM and FEHB do not afford a retiree the ability to buy a wrap-around plan. That is what we would like to do. We would like to work with them to set that kind of a plan up to reduce the overall cost.

From a Medicare perspective, the cost increase for Medicare on a yearly basis would be somewhere between $1 billion and $1.3 billion a year, so you are trading $55 billion in on the overpayment for us for a $1 billion cost increase.

Senator JOHNSON. OK. And I understand that with the Postal system, but, again, I think it is important to point out that additional cost is going to be borne within the Medicare system, which, according to my 30-year projection, is about a $36 trillion deficit in Medicare over the next 30 years. One dollar of payroll tax going in, $3 of benefits going out. So, again, I understand how you are responsible for the Postal system, but I think it is important to point out from the Federal Government's standpoint, we are not saving anything.

Mr. DONAHOE. We have no argument——

Senator JOHNSON. We are kind of just shuffling——

Mr. DONAHOE [continuing]. No argument with that. We agree that Medicare needs to be fixed. All we are asking for is a level playing field.

Senator JOHNSON. OK. Thank you.

Chairman CARPER. Thanks, Senator Johnson.

Senator Baldwin, welcome. Thank you.

OPENING STATEMENT OF SENATOR BALDWIN

Senator BALDWIN. Thank you, Mr. Chairman. And I appreciate your providing a number of hearings on the draft legislation that you and the Ranking Member have introduced.

I wanted to ask some questions related to input that I am hearing from my State and my constituents. In some ways these sort of changes affect all 50 States in similar ways, and then there are unique ways in which they impact States. Wisconsin is actually the No. 1 State in terms of paper production, and since what is sent around in the mail is usually on paper, we have a real impact. And so this legislation affords the Postal Service far more authority in setting its own rates above the rate of inflation and without prior authorization from the Postal Regulatory Commission (PRC).

I am wondering, Mr. Donahoe, if you can talk a little bit about how you and the Postal Service will be good stewards of this expanded authority, and especially as it affects the paper industry and those obviously who rely heavily on your services.

Mr. DONAHOE. Thank you, Senator. I think that your point about paper is very true because 40 percent of paper ends up in the mail, and that is why the entire industry from the forestry and the paper producers and the printers and logistics providers sees it as critical that we resolve this issue, because there are substantial numbers of jobs that are affected by what we will decide here in the next couple of weeks and months.

From our perspective, we think that the Board of Governors, as we talked about last week, should have the authority to set prices because we have the responsibility to manage the organization. I think that if you took a look at our 5-year plan, and we have done an actual look ahead 10 years, we have never included anything more than a Consumer Price Index (CPI)-based price change in those plans. We think that there is a balance that must be achieved, especially addressing big costs like health care, along with some other infrastructure changes that we are proposing going forward to keep the Postal Service viable.

We know that big price increases will dampen the demand for mail and hurt not just the Postal Service but the entire industry. Our Governors take that to heart, and we agree 100 percent with you that is something that must be considered.

Senator BALDWIN. A century ago, Wisconsin passed the Nation's first workers' compensation program. Interestingly, it was under Governor Robert M. LaFollette, Sr., who at one point was a U.S. Senator in the seat that I now have the distinct honor of holding. We called him "Fighting Bob LaFollette." So I know that there are a lot of provisions in this draft bill that make very significant changes to the Federal Employees Compensation Act (FECA), which is obviously relating to workers' compensation, and that the draft bill contains changes not just for the Postal Service workers but for workers throughout the Federal Government that result in benefit cuts, as I understand it. Under the cuts in the draft, Postal workers would receive 22 percent less under the Federal Employees Compensation Act than if they had worked a full career for non-postal Federal employees, cuts are around 35 percent, if I read this correctly. And I have some strong concerns about this because it is my further understanding that this cut does not necessarily solve the long-term financial problems of the Postal Service.

Also in the bill, obviously, there are changes that have been proposed in the prefunding of retiree health care plans from 100 percent to 80 percent. I think that is a step in the right direction. But I have heard from actuaries that we could go further, and I have heard perhaps as low as 30 percent, which would put the Postal Service on a path to sounder financial standing.

So I guess the question is: Why would we go in the direction of cutting Federal employee workers' compensation benefits when the Postal Service actual financial problems can be better solved by further reducing the prefunding of the retiree health care? I want to ask that of you, Mr. Donahoe.

Mr. DONAHOE. OK. Thank you, Senator. A couple things on workers' compensation. First of all, I think it is important. Safety is a critical issue for the Postal Service. We have worked very well with the unions and the Department of Labor (DOL) over the last number of years to improve on that. Our illness/injury rate has dropped more than 50 percent. We are very proud of that. We have been very active—as a matter of fact, before the last couple of years, we were the No. 1 what is called the Voluntary Protection Program (VPP). It is the Occupational Safety and Health Administration (OSHA) VPP process that really recognizes people for having a safe workplace. We cannot agree any more strongly that the workers' compensation issues are a major issue. We do not like to see our employees get hurt.

One of the things that we are faced with, though, is a liability. You heard the gentleman from the GAO mention that we have outstanding liabilities. Our liability for workers' compensation right now is $16.5 billion, and we have 16,000 people on the workers' comp rolls. It would be in our best interest from a Postal Service perspective to do a couple things.

No. 1, be able to reemploy these people. Many of them would like to come back to work, and we need to find jobs that they can do, and it certainly would help us.

The other issue—and I think this is what is being addressed by the bill itself—is we have to find a way for a person to move off the rolls. We have people right now in their 80s and 90s, we have a couple people over 100 years old still on workers' compensation. And there is no real incentive to leave that, and I think that is being addressed by the bill.

But the key thing is accident reduction, do not let people get hurt, keep them safe.

Senator BALDWIN. I know I do not have a lot of extra time, but let me just try to add one more comment. You can react to if, you please.

I have heard certainly from Postal workers in Wisconsin some concerns as we look at the staffing overall of the Postal Service that it is management heavy. And, I understand that you look at that in terms of ideals, management to craft employee ratio carefully and have ideal levels. I would just say in terms of optics we just had over the August work period an announcement of a closure of, at least, origination mail processing in my home town of Madison. Fifty-four employees were told that their jobs would be phased out and that the operation would move to Milwaukee at the same time as an announcement of three additional management staff being added to the same operation. So 54 are leaving, 3 management being added. Optics, it did not look very good.

Mr. DONAHOE. I would like to respond to that. Optics does not, and that is not something I stand for whatsoever.

In the last 5 years, the Postal Service has reduced the head count by 205,000 people. American Postal Workers Union (APWU), the clerks union, has taken the largest hit. They have had a reduction of 37 percent. Management is at 32 percent. I take it very seriously that we do not pad management ranks. It is my feeling that our employees do the work every day; there is no reason why all of us should not be under the same requirements for change. We have not taken raises. We have not taken bonus money, pay for performance, anything like that.

In terms of the rest of the crafts, mail handlers, letter carriers, rural carriers have taken a smaller impact, but, of course, with the route structure that we have today, you would expect that. But we are very serious about it, 32 percent, and I will look into the numbers up there in Madison.

Thank you.

Chairman CARPER. Was there a time not long ago where senior management did not contribute to their health care coverage?

Mr. DONAHOE. We did not at one time, and this year we are contributing about 28 percent.

Chairman CARPER. Good. Thanks very much.

All right. Next up, Senator Ayotte, and then Senator Tester.

OPENING STATEMENT OF SENATOR AYOTTE

Senator AYOTTE. Thank you, Mr. Chairman.

I wanted to followup, Mr. Dicken, on the question that Senator Johnson asked, because it just was not clear to me. Obviously, we are concerned about the fact that Medicare is scheduled to go bankrupt in 2026, and that this is a very important issue that needs to be addressed by the Congress as a whole to preserve Medicare for future beneficiaries and those who are going to rely on this important program, and also for fiscal responsibility and sustainability. So do we know at all, if we do this proposal with the implementation of the Postmaster General's plan, do we have any numbers of what the impact would be on the solvency of Medicare?

Mr. DICKEN. What we do know based on the Postal Service's proposal that we examined, and their estimates, is that for the first 5 years, the average increase in costs to the Medicare program would be $1.3 billion. That is the annual increase. That is a fairly small share of overall Medicare spending, which is over $550 billion a year, but it certainly needs to be weighed given that both programs are facing long-term fiscal sustainability issues.

Senator AYOTTE. And also with 44 percent of the Postmaster General's savings for 2016 coming from the Postal health plan, if enacted, this would be, I think, one of the largest determinants, if we adopt this proposal, of the postal health, financial health. And are there examples of similar withdrawals from FEHBP—I love acronyms in Washington—or restructuring? And what lessons can we take from those other examples to include in this proposal to make sure that this is successful? Have we done something like this before in another context that we can use as an analogy?

Mr. FOLEY. There have not been withdrawals of this scale. There were withdrawals in the late 1980s and in the Federal Reserve and the Federal Deposit Insurance Corporation (FDIC). They returned to the FEHB in the late 1990s. It was a relatively small impact, but it was somewhat disruptive to have that in and out——

Senator AYOTTE. So they got out, and then they got back in?

Mr. FOLEY. Exactly.

Senator AYOTTE. Is it because it did not work or is it because they did not realize the savings that they thought or for whatever reason they got out?

Mr. FOLEY. They have separate authority to get out. I was not there at the time, but my sense was that they thought that they could strike a better deal with insurance companies by moving out. And that turned out not to be the case.

Senator AYOTTE. And so how confident are we that we can strike a better deal here?

Mr. DONAHOE. I think that we can. I think that when you bring a force of 1 million people to the marketplace, you have a lot more impact. I think that the reason the FDIC—and we will research this for you—went back was because they were faced with having to prepay retiree health benefits, and so they turned around and went back into the plan so they did not have to prefund them.

But in our case, we have a million people, retirees and currents. We would be the largest single insured organization in this United States. We think that between either a plan with one provider or a set of providers, we would have the ability to force competition.

Now, that said, we also have said in my testimony that we are perfectly willing to work with FEHB and carve out, as you would say, maybe a set of our health benefits plans. The unions and the Postal Service have worked, and we have identified about 16 plans that have over 90—it is probably about 95—percent of our employees. If we took them and if we competed that and if we required those plans to provide the wrap-arounds for our retirees, it would answer the same issues that we are looking for right now. There are ways forward, plenty of options. We are not steadfast on one.

Senator AYOTTE. So we are talking about if we take the Medicare piece, what does that do to Medicare, so it is a shifting of Federal dollars that Senator Johnson talked about as well. So if you get out of FEHB and then you go out on your own, you have a million people, do we have any sense of whether that drives up the costs in FEHB? In other words, are we going to be shifting on that end? Have we done any numbers on that? Do we have a sense of—as we look at the big Federal picture here that we are responsible for?

Mr. DONAHOE. Sure. I think that both the GAO and the OPM have already commented on that. Do you guys want to——

Mr. FOLEY. Yes, and it really depends on which population is taken out. The Medicare A and B population by carving them out has a 2-percent impact, increase in the premiums for the remaining FEHB population. So that was what I was speaking to in my testimony. And GAO can speak for themselves. The analysis they did was based on a slightly different proposal, so the impact was different.

Mr. DICKEN. And certainly when we looked at pulling entirely the Postal employees and retirees out, overall, even though that is a large percentage, 25 percent of current enrollment in FEHBP, the effect was modest for most plans that we talked to. The plans indicated that there might be small premium changes, increases in——

Senator AYOTTE. So, in your opinion, if you are looking at the Federal Government as a whole, is it a net gain—in other words, a savings I meant to say.

Mr. DONAHOE. From a Federal Government——

Senator AYOTTE. From a whole of Federal Government perspective.

Mr. DONAHOE. What I would tell you would be the whole Federal Government should compete their health care plans, instead of sitting with what we have with 200 health care plans that are not competed today. And I would tell you the whole Federal Government should take the same approach with the wrap-around, because the difference with us is this: Ratepayers pay our funds. Taxpayers pay for the rest of the government. That is why we have insisted we should be treated like a private entity. We are already—from a Medicare perspective, 92 percent of our employees use Medicare A who are 65 or older, 77 percent use Medicare B. That is why it is not such a big hit on Medicare. We are paying for D. We do not have the access to it. All we are saying is this resolves a substantial portion of our problem for the Postal Service. It also protects our ratepayers because they are much more like a private sector company than the rest of the Federal Government.

Senator AYOTTE. And I know that my time is up, but just on the ratepayer issue that I know others have asked you about as well, with the drop in volume—and I know that is why you are here so that we can make reforms that are appropriate to protect ratepayers, but also to make sure that people get service and the Post Office continues to thrive. Do you think that one of the issues when you look at the financial piece of this here, you have $63.5 billion in unfunded health and pension liabilities, and so as we look forward, a lot of it we are talking about, OK, we are going to put a bunch of it on future ratepayers as well. And so how do we look forward toward—given the drop in volume we have seen, there are a lot of businesses that are relying on the Post Office as well. I mean, how do you view our ability to balance that? And I think that is a really big concern that many of us have of making sure that, yes, you do run it like a business, and in order to run a business, you would also make sure your customers are still there for you.

Mr. DONAHOE. That is a key critical issue. That is why we are here. Addressing the long-term health of the Postal Service is critical for a very large industry, and we have to get this resolved now. We have to get it done right. So resolving the health care, making changes in our infrastructure, moving from 6-day to 5-day, making some changes as we have done with our unions, working through and having more non-career flexible people in the workforce, we have made some proposals on long-term retirement changes. We think that we have an excellent 5-year business plan with a 10-year look ahead that puts the Postal Service on very sustainable, firm ground for the next 10 years.

The key issue here is to resolve this so that from a Postal Service perspective and an industry perspective we can start to innovate and grow this industry. The mail is still the best way to get in front of somebody's eyes if you are sending a message, much better than the Internet, much better than any other way, because it is the most direct way to get there. So resolving this and getting back on growing this industry is critical.

Senator AYOTTE. And doing nothing is essentially, let us just let it go to bankruptcy, right? So we need to——

Mr. DONAHOE. That is why we are here.

Senator AYOTTE [continuing]. Get this done, is your message, right?

Mr. DONAHOE. You will never hear me say, do nothing. I mean, I probably do not have a lot of friends in Washington, but the issue is trying to make these changes so we can grow a very important industry and keep it healthy going forward.

Senator AYOTTE. Thank you. I appreciate all of you, and I know that this is not an easy problem that you have been asked to solve, so we appreciate that you are taking on these hard questions.

Chairman CARPER. I am Tom Carper, and I agree with that message. [Laughter.]

And I am anxious to hear Senator Tester, his comments and his questions. Jon.

OPENING STATEMENT OF SENATOR TESTER

Senator TESTER. Thank you, Mr. Chairman.

I guess this question is either for Mr. Todisco or Mr. Dicken, and it goes back to the questioning that Senator Johnson asked. There is a $49 billion additional liability to Medicare if the changes are made to FEHBP. I believe you said that, Mr. Dicken. Is that correct?

Mr. DICKEN. That $49 billion of the financial gains to the Postal Service are for the more full integration with Medicare. That is composed of costs to the Medicare program, additional premium payments from Medicare Part B, as well as drug payments to drug manufacturers.

Senator TESTER. OK. So I will ask it again, and you tell me what the figure is, if it is not $49 billion. If the plan is implemented, there is a $49 billion liability to Medicare. And if it is not $49 billion, just tell me what the number is.

Mr. DICKEN. Indeed, the $49 billion offset, that is coming from different funding streams through the Medicare program, some through the trust fund, some through savings in the drug benefit, some through premiums from beneficiaries.

Senator TESTER. OK.

Chairman CARPER. Could we just drill down on that for a moment? Let us go to other folks on the—I was thinking it was about $900 million a year, is my recollection. But, Postmaster General, can somebody else——

Mr. DONAHOE. I think that the increase in the liability, Senator, to Medicare from our estimates and what we have shared with the GAO would be about $1 billion in year one and then $1.3 billion from there, because if you remember, a substantial number of our people already use Medicare, so the transition of those last ones would not really hit Medicare a whole lot harder.

Senator TESTER. OK. So——

Chairman CARPER. Dr. Coburn——

Senator TESTER. Go ahead.

Senator COBURN. Let me add one other comment.

Chairman CARPER. This will not come off your time, Jon.

Senator TESTER. That is good.

Senator COBURN. This differential is in the difference of what the post office could buy the exact same coverage with a wrap-around—no, but most of these savings—$1.3 billion a year, you multiply that times 30 years, that is $29 billion.

Senator TESTER. That is real money.

Senator COBURN. OK. That is real money. But most of the savings comes from the difference in purchasing the exact same thing from purchasing a different way. There is no question we add to the liability of the Medicare program.

Senator TESTER. And that is the number I want to get, and——

Senator COBURN. And that is $1.3 billion a year.

Senator TESTER. And I think we are talking to the GAO folks. I mean, you guys know this stuff, right, inside and out?

Senator COBURN. It is their testimony.

Senator TESTER. Yes. So where did the $49 billion figure come from? Is that the total liability of the $1 billion per year initially and 1.3 years after that?

Mr. TODISCO. No, it is not. There are two figures out there as you have identified. The $1.3 billion is the annual increase in Medicare costs over the next 5 years. The $49 billion is a reduction in the Postal Service liability. That liability is a present value of payments going decades into the future. And the $49 billion consists of increased costs to Medicare as well as other elements such as participants paying Part B premiums, as well as discounts from the pharmaceutical industry from the Part D program.

Senator TESTER. Do you have a breakdown on that, by the way?

Mr. TODISCO. We do not have a breakdown on that.

Senator TESTER. Would it be a lot of work to get that breakdown?

Mr. DONAHOE. We can give that to you. We have a breakdown.

Senator TESTER. OK. I would like to do that. Thank you.

Postmaster General Donahoe, last week I asked you if the post office would be closing post offices and processing centers while this debate of this current bill was going on, and you said, "No, we have done what we need to do for the year." Yet just this week, I have heard about more closures. I mean, basically what I want to know is what do you mean? There have been more closures or consolidations, so what did you mean when you said, "We have done what we need to do for the year"?

Mr. DONAHOE. Here is where we are right now: For fiscal year 2013 that we are in, we had a series of plants that we were consolidating. We also had a set of what we call stations of large post offices that we were either consolidating or moving. And then we are working through what is called the Post Plan, which is the smaller post offices moving to part-time hours. We are finishing that up for this year.

When you asked me would we advance anything from next year in, I said no, we would not, and we would not do that. The Post Plan has been an ongoing plan. That is where we have been reaching out with the local people. Plants, we would not make a change.

Senator TESTER. And that plan goes through the end of this calendar year?

Mr. DONAHOE. The Post Plan will go to the end of next fiscal year, which will be September 2014, and that is the small offices transitioning.

Senator TESTER. So what you are saying is through September 2014, next year, there are already things in motion that are going to close down processing centers and post offices. It is already in there. I am not talking about reduction of hours, just closures. The processing centers and post offices.

Mr. DONAHOE. OK.

Senator TESTER. And that plan goes through the end of September of next year, a year from now.

Mr. DONAHOE. Reduction of hours in small post offices is scheduled, and that is moving through. We are finishing up consolidation of plants now in fiscal year 2013. We will finish that before the holiday season. The ones that we have on target for next year—we have some starting in February, March, April of next year—those are the ones that I told you we would not advance. Where we are right now, we will freeze any of those in 2014 pending the outcome of the legislation and just finish up what we have now, because these take time. If you want to do them right, you have to be very careful——

Senator TESTER. There is no ifs, ands, or——

Mr. DONAHOE. You have to do it the right way.

Senator TESTER. No ifs, ands, or buts about that, Postmaster General. I just want to know what we are doing, OK? And I still do not know. So the question is: At what point in time are your plans to stop closures going to stop? OK? So is it the 1st of December of this year? Is it the 1st of January next year? Or is it the end of September next year?

Mr. DONAHOE. Let us walk through; there are three streams, OK?

Senator TESTER. OK.

Mr. DONAHOE. Start with the smallest ones first. We have about 6,000 small post offices that we are in the middle of transitioning from 8 hours——

Senator TESTER. Reduction of hours.

Mr. DONAHOE [continuing]. Or 6 hours, down to 2, 4, and 6.

Senator TESTER. OK.

Mr. DONAHOE. That will continue to go through. We are trying to do that in a very organized manner so it does not disrupt customers. The other thing we are trying to do is make sure that our employees have a landing spot coming out of that. So that is one.

Senator TESTER. That is fine.

Mr. DONAHOE. The second one is in some of the larger cities we have excess facilities, we have excess space.

Senator TESTER. OK.

Mr. DONAHOE. We are in the process of moving those around to get rid of excess space. That is the second.

Third are plants. So we are finishing up some plants right now. That will be done for the year before the holiday season, so that will finish up in November.

We have additional ones scheduled for next year. Those are the ones I told you would not be advanced into this year. We will wait and see what happens with legislation.

Senator TESTER. Got you. OK. Is it possible to get that list of——

Mr. DONAHOE. Sure. We will come over and go through that with you.

Senator TESTER. Thank you very much.

I just want to clarify something else that came up in last week's hearing and just correct me if I am wrong. I think that you stated it is your belief that under the current contract an arbitrator cannot consider the financial health of the United States Postal Service.

Mr. DONAHOE. I misspoke. What I should have said was that they can consider it, but they are not required by law not to consider it. I think that is where I misspoke.

Senator TESTER. OK.

Mr. DONAHOE. OK? I think that we clarified that for the record already, Senator. My people said, "I think you said the wrong thing."

Senator TESTER. Not that we ever make mistakes, so, yes, because I think the last three arbitrations there was a lot of financial——

Mr. DONAHOE. Oh, yes, absolutely.

Senator TESTER [continuing]. By the Postal Service.

Mr. DONAHOE. There is no requirement, but yes.

Senator TESTER. Thank you.

Thank you, Mr. Chairman.

Chairman CARPER. I am going to come back to you, Postmaster General, for something, but before I ask you, let me telegraph my pitch. I want you to again just lay out—you are good at this. I just said to Dr. Coburn, I said, "The Postmaster is pretty good at explaining this stuff," so I am going to give you a free, clear shot just to explain again what we are trying to do with respect to Medicare, what we are trying to do with respect to FEHBP, and what we are trying to do with FERS and so forth, just to kind of go through that. And then refer to some of the concerns that have been raised about that path forward, all right? And then rebut those. That is what I am going to ask you to do.

Before we do that, I want us to keep this in mind. As important as the health care issues are to the long-term solvency of the Postal Service, it is not the whole ball game. As important as Medicare is, the prepayment for the retiree benefit, that is all important. As important as the FEHBP coverage is, Medicare A, B, D, all that is important. But let me just put it in context. Context includes last week's discussion. Context includes how do we enable the Postal Service to take this legacy organization, this legacy distribution system, and in the 21st Century make money with it? How do we do that? Is there a way to do it delivering mail 6 days a week? If there is, what do we have to do with respect to pension obligations? What do we have to do with respect to health care, with Medicare, and all that? That all kind of works together.

The Postal Service has done I think good work, I think humane work with respect to reducing distribution centers—and that is a big deal—from 600 to, gosh, 325 or so. And in our bill, we just basically say, OK, let us hold it there for now.

Great work has been done I think in a humane way with reducing the head count from 800,000 employees a decade or so ago down to under 500,000, in a humane way.

So all that has been done or is well on the way toward being done. So it is not just about health care. It is not just about Medicare. It is not just about pensions. But we need to do really something responsible, humane, and effective in all those areas if we are going to be successful in closing this $20 billion bogey.

All right. General, that is the setup, and then the question is—hit us with your best shot. Make the case for the kind of reforms that we are talking about, that you are suggesting, that Dr. Coburn and I are trying to include in our legislation. Any criticism that you have heard that you would like to rebut, please do that. Thank you.

Mr. DONAHOE. Well, thank you, Mr. Chairman. Let me start, if I could, with health care. We feel it is our responsibility to prefund health care if we expect to keep it as a benefit. That is our responsibility, so you have never heard us say we should not do it. You have never heard us say that we should walk away from that. We have to resolve the problem.

I think it is critical that people understand what the drivers are in this whole area. Our plan is to integrate Medicare because we think that we have paid into Medicare, it should be integrated, because our revenues are based on ratepayer revenues, not taxpayer revenues. So there are a couple key numbers that you have to consider.

No. 1, a retiree from the Postal Service at age 65 pays an average of about $7,000 a year for a health care plan. That is the total cost, us and them. And that goes across the board, and that is done every year—this person makes that payment.

The second thing is we are the second largest payer into Medicare, the Postal Service is, and we, unfortunately, are not able to take full advantage of that payment into Medicare because of the lack of requirements to use those benefits. So, A, we have 92 percent; B, we have 77 percent. By law we cannot use D.

The third thing is this: In the private sector, an average health care cost plan is somewhere between $4,000 and $4,500 a person. That differential is what is driving all of this cost. So when you look at the long-term with that differential, and resolving that it cuts in half the health benefit payment into the prefunding that we need to make—if we can resolve that issue, if we can integrate Medicare and use that system that we have paid into and get the right health care payments based on what our ratepayers should be paying, we for all intents and purposes eliminate the need for any further prefunding. We will, therefore, be overfunded into FERS, within $16 billion funded into a $200 billion Civil Service Fund, we will be fully funded into the retiree health benefit, and that puts us in an excellent position going forward. The going forward is a critical thing.

If you look forward in this organization, paper, over time, will start to disappear. That is why we have been so active in the package business. We know there are big opportunities there. We are not giving up on paper, but we know that if you take a long look on this, we will have issues going forward. And so that is why it is critical for us to resolve a number of these other issues.

Getting the FERS payment resolved is also critical. All we are asking is paying our fair share. We overfund FERS right now by about $300 million a year. We have overfunded into that a little bit over $6 billion. We would like to take the $6 billion back and put it against our debt. That almost cuts our debt in half.

Our goal in terms of debt is to be debt free by 2017 so that as we have declining volumes—and we project about 5-percent first-class decline in a year for the long term—we will be in good shape going into 10, 15 years out in a debt-free environment.

Other critical areas that we do need help is flexibility in terms of pricing and governance around what we do with products. We think that there are big opportunities still in the mail. It has to be affordable. We think there are big opportunities in the package business. It has to be affordable. We know that. But you also must act quickly. That is why we have asked to give us after-the-fact review instead of this laborious process that we have to go through still from a rate case.

We had to file yesterday in order to make a rate change in January. I mean, we buy fuel every day, and the person changes the price with the flick of a switch. That is not a good environment to be in if you are trying to fight for your lives.

The other key critical issues going forward is the ability to use the Postal Service, our resources, like our post offices, like our law enforcement, to play a key role—not competing with the private sector—but playing a key role in digital going forward. We talked about that last week. That is also in your bill.

We fully support what is in your bill. We think it is very good. What we are looking for is just a little bit more clarity around the Medicare integration, and I think that will get us over the finish line.

Chairman CARPER. Well said. Thank you very much for that explanation. Dr. Coburn.

Senator COBURN. Just a little history on Medicare. When Part B was started, it was to be a 50–50 payment differential between the participant and the government. We are at 25 percent.

Now, on average, the average couple pays in $110,000 for Medicare during their working lifetime and takes out $330,000. Senator Johnson has raised the concerns, about this unfunded liability's impact on Medicare, and I understand why we would want to look at the whole picture. But the fact is that fairness plays a role. There is not anybody else out there that cannot take advantage of Medicare if they paid into it. And what the Postal Service is saying is if we can provide exactly the same thing to our employees that they are getting today, at $2,800 per retiree per year cost difference, then we ought to be allowed to be able to do that.

Now, that is a lot of money in terms of their cash-flow, and that is giving an equal service, not a poorer service, an equal service to their employees.

So what we have to do is, as Senator Carper said, how are we going to look at all these pieces and try to come up with something that gives us long-term viability of the Postal Service, and that is the real issue.

I have a question for you, Mr. Postmaster. One of the things that has really concerned me is the Department of Labor has recently suspended the transfer of the Federal Employees Compensation Act data to you all, which is crucial to ensuring your program integrity and good service to your employees. Can you please describe to the Committee the impacts that the Department of Labor's decision is having on you as an entity and also on your employees?

Mr. DONAHOE. Thank you, Doctor. The suspension is a problem for us. As I mentioned to Senator Baldwin before, safety is critical, and we are very proud of the fact that we have reduced the illness/injury rate by 50 percent. However, we have 16,000 people on workers' compensation periodic rolls right now, and it has been our goal and it is consistently our goal to try to get them back to work. And part of the back-to-work process involves working with doctors, it involves working with our unions, it involves working with many people, and sometimes outside people, because we have actually placed people in jobs outside the Postal Service.

The fact that everything is moved back to paper now is a major problem because it makes it much harder in terms of moving that information data around. I think there were some concerns about privacy. We have always taken the utmost care to protect the privacy of any individuals, and we will continue to do that. And we look forward—I have written the Secretary a letter—I would like to go up and sit down with him and work through this because it is in our best interests to get people back to work. We have a $16.5 billion liability in workers' compensation, and we have to address it, and the best way to address it is get people back to work.

Senator COBURN. Yes, and a specific problem as far as you cannot get the case numbers, one.

Mr. DONAHOE. Yes.

Senator COBURN. Your injured workers have tripled, with third-party billing and medication. Subrogation of claims data, you cannot get that.

Mr. DONAHOE. Right.

Senator COBURN. And you cannot get any case verification or inquiries.

Mr. DONAHOE. No.

Senator COBURN. All right. Mr. Foley, I had one other question. In your testimony, you said that the overall management cost of FEHBP is 0.8 of 1 percent. Is that the management cost inside the government, or is that the management cost including your major contractor who runs this program?

Mr. FOLEY. OPM runs the program. We have health plans that incur administrative costs, and that is built into their premiums. But the number I cited was reflective of OPM's costs.

Senator COBURN. So that includes the management costs of the health plans that run this program, that 8——

Mr. FOLEY. No, it does not.

Senator COBURN. What is that figure as a percentage of the total cost?

Mr. FOLEY. It varies by plan. The larger plans are between 5 and 6 percent, the large national fee-for-service plans. The smaller Health Maintenance Organizations (HMOs) are between 10 and 15 percent.

Senator COBURN. All right. Thank you. I think I will submit the rest of my questions for the record so we can get to the next panel.

Chairman CARPER. OK. Fair enough. Senator Johnson, please.

Senator JOHNSON. Just a couple quick ones.

First of all, so my questions are not misinterpreted, I have a great deal of respect for Tom-squared here in terms of what they are trying to do, and, Mr. Postmaster General, if it were up to me, I would set you free. I am incredibly impressed with what you are trying to do and the challenges you face.

Just kind of getting back to the whole Medicare issue, talking about 77 percent of Postal employees already taking advantage of Part A and B, whatever that is, do we know a calculation of what it costs Medicare currently on an annual basis?

Mr. DICKEN. I do not think we have a breakout for Medicare costs for Postal employees——

Senator JOHNSON. Do you think it is more than $1.3 billion that we would be saving annually? I mean, are there—in other words, the Postal employees are already into Medicare for $5, $10 billion a year. I am just trying to get some sort of sense there.

Mr. DICKEN. We do not have the number, but given that is the majority of the postal retirees, that would be a larger cost.

Senator JOHNSON. OK. That would be something I would like to find out. It is kind of a key point.

Mr. Donahoe, can you tell me, why is there such a big difference? What is the difference between the $7,000 and the $4,500 in terms of a Postal Service person, a retiree at the age of 65 versus the private sector?

Mr. DONAHOE. Sure.

Senator JOHNSON. Is it more generous benefits?

Mr. DONAHOE. First, Senator—no. It is not that at all. I think that if you asked Mr. Foley, he could tell you that there are no wrap-around plans available right now within FEHB. There has never been an incentive to actually encourage people to use the Medicare wrap-around because, from a taxpayer's perspective, that would be considered a shift of costs from another Federal agency onto Medicare. From our perspective, the fact that our ratepayers pay our way, we look at ourselves much more from a private sector perspective. And so what we are saying is rather than paying a higher-priced FEHB plan, we would much rather have the lower price than have the accounting and the actuarial numbers go against that number like——

Senator JOHNSON. But basically the $7,000 pays for the entire health care cost where the $4,500 is a wrap-around plan around Medicare.

Mr. DONAHOE. Right. It is inefficient. We are paying for more than we need. You do not need a big——

Senator JOHNSON. No, I understand, but so really you have less value in terms of what the $4,500 is buying than——

Mr. DONAHOE. The $4,500 pays for what you need. What you end up doing, it would be like—it is like throwing $3,000 down the drain.

Senator JOHNSON. OK. Let me go back to GAO. Do we know the total value paid by postal workers into Medicare today, the total value? Is it $50 billion? Is it $100 billion?

Mr. DICKEN. I believe the Postmaster General gave you what——

Mr. DONAHOE. $27 billion.

Senator JOHNSON. $27 billion to date? OK. That is really all I have Mr. Chairman. Thank you.

Chairman CARPER. It is $27 billion per——

Mr. DONAHOE. That is since inception.

Chairman CARPER. Day, week, month, year?

Mr. DONAHOE. Total since 1983.

Chairman CARPER. OK. All right.

Senator JOHNSON. Let me just clarify that. My understanding, that is the amount of payroll taxes paid by postal employees into the Medicare system from its inception of Medicare to date?

Chairman CARPER. No, I do not think so. Can——

Senator JOHNSON. OK, well, as long as they have been doing it, then. OK.

Chairman CARPER. Let us just make sure we get a correct answer to all of us on the record. OK? On that question.

Mr. DONAHOE. Can I ask a clarifying question?

Chairman CARPER. Please, sure.

Mr. DONAHOE. Do you want to get that from the GAO or from us?

Chairman CARPER. Both.

Mr. DONAHOE. OK. Will do.

Chairman CARPER. And then we will compare.

Senator COBURN. Let us get it from both so we can see where the discrepancy is.

Chairman CARPER. All right. I asked Dr. Coburn if he had any more questions, and I think not, nor do I, not for this panel. It has been a real good conversation and given us some great input, and some clarification is still needed.

One of the questions I have is for you, Postmaster General. It sounds like there needs to be a conversation between you and the Secretary of Labor on the workers' compensation issues, some of the FECA matters. Can we be helpful there in facilitating a good conversation, we want to be helpful.

With that having been said, we are grateful for your testimony, for your work, and look forward to continuing to work with you to—if it is not perfect, make it better. We know what we have introduced is pretty good. We think it is. We know it is not perfect. We want to make it better. Thank you very much. [Pause.]

I am going to ask the second panel to take their seats, please. I would ask the audience to help us restore some order here.

Gentlemen, welcome. How many of you were here to hear the testimony and the questions for the first panel, raise your hand. It looks like everybody was. Good. Thank you for doing that. Almost everybody was.

I am happy to see the Postmaster General and Deputy Postmaster General are remaining for the second panel. I think that is very helpful. That is something that Dr. Coburn has always suggested. I am glad you are doing that. But let us welcome our second panel.

Our first witness on panel two is Fredric Rolando. I love to say that name. Mr. Rolando has served as president of the National Association of Letter Carriers (NALC) since 2009. His own career as a letter carrier has spanned three decades dating back to 1978.

Next we have John Hegarty. Mr. Hegarty is national president of the National Postal Mail Handlers Union (NPMHU), a position he has held since 2002.

Our next witness is Bob Rapoza, and Mr. Rapoza has been the president of the National Association of Postmasters of the United States (NAPUS) since 2010, and he told me earlier today that he is going to turn that post over to his successor in the not too distant future. But it has just been a real pleasure working with you, sir.

Next we have Douglas Holtz-Eakin. Mr. Holtz-Eakin has served as president of the American Action Forum. Prior to his current position, Mr. Holtz-Eakin served as Commissioner on the Financial Crisis Inquiry Commission and led the Congressional Budget Office (CBO) as its sixth Director from 2002 to 2005. Doug, it is great to see you. Welcome.

And, finally, Dean Baker. Mr. Baker currently is the co-director of the Center for Economic and Policy Research, a position he has held since 1999. Dr. Baker, good morning.

Your entire statements will be made part of the record, and we will ask you to summarize as you see fit, and we are just glad you are here. Welcome to this conversation and the conversations that will follow. Thank you. Mr. Rolando.

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

Mr. ROLANDO. Thank you, Chairman Carper and Dr. Coburn and the rest of the Committee, for the opportunity to testify today on behalf of the 270,000 members of the NALC. My name is Fred Rolando. I am a letter carrier from Sarasota, Florida, currently serving as the president to the NALC.

I would like to cut right to the chase because the 7 minutes went down to 5, it looks like.

Chairman CARPER. Take 7.

Mr. ROLANDO. While we appreciate very much your hard work in putting together S. 1486, we feel that the bill fails to permanently address the primary cause of the current financial crisis: The unaffordable mandate to prefund future retiree health costs.

This unique mandate is responsible for 80 percent of the losses incurred since 2007 and 100 percent of this year's reported loss. Instead, the bill offers a 3-year moratorium and a new system of prefunding payments that will be greater after 2015 than they are today, at which time the Postal Service will again default.

That inadequate prefunding proposal, combined with the prospect of large postal hikes, the elimination of Saturday mail delivery and business door delivery, the phase-out of household door delivery, and the promotion of a morale-killing two-tier postal workforce would drive the Postal Service into a death spiral.

Although these proposals are intended to protect taxpayers should the Postal Service fail, we feel the bill would instead lead to the failure of the Postal Service, ensuring that taxpayers are left on the hook, while damaging the mailing industry and the U.S. economy.

As we meet today, the Postal Service is not in a free fall. Its pensions are nearly fully funded, even with the unfair accounting methods that are in place. We have amassed $49 billion for retiree health that we have no access to. The Great Recession is over, and the Internet is creating new business for us, not just diverting it. The Postal Service has returned to operational profitability this year so far.

Thanks to the hard work and the sacrifice of postal employees, who endured huge job cuts and painful concessions in the last round of collective bargaining, and to the surging package revenues, the Postal Service made $660 million in the most recent quarter—a profit that, of course, was wiped out by a $1.4 billion charge for the prefunding.

This success has been made possible by our high-quality workforce and our successful system of labor relations, which has ensured quality service at the most affordable rates in the world for 40 years.

[1] The prepared statement of Mr. Rolando appears in the Appendix on page 489.

The proposals to interfere with that system are based on misinformation, some of which was discussed earlier and brought up by Senator Tester. I would like to further clarify what the Postmaster and Senator Tester were talking about.

Arbitrators are indeed required to consider the financial position of the Postal Service if it is raised by either party, which it has been in every interest arbitration since inception. Congress should reject these proposals along with drastic cuts to workers' compensation benefits and focus on the elephant in the room—the prefunding.

Solutions to the Postal Service's prefunding problem can be found in reforms that are outlined in my written testimony.

First, if measured accurately and fairly, the Postal Service's pensions, which, again, are nearly fully funded, would be massively overfunded. Unfortunately, the OPM continues to use outdated valuation methods to measure the Postal Service's assets. We welcome S. 1486's proposal to measure the postal accounts with postal-specific assumptions. But we urge the Committee to go further by implementing the PRC's 2010 audit of the Postal Civil Service Retirement System account, done by the Segal Company, which uses modern private sector methods. The resulting pension surpluses could be used to pay down the Postal Service's debt and to fully fund its future retiree health benefits.

Second, we feel the OPM should be directed to invest the funds of the retiree health fund in a way that responsibly maximizes its returns.

Third, we feel that Congress should seek reforms in how FEHBP and its participating plans cover postal employees to reduce the costs of retiree health benefits and, therefore, lessen or even eliminate the unfunded liability.

Together, we feel that these steps would allow us to focus on growth and innovation that would exploit our best assets, not destroy them.

Mr. Chairman, at last week's hearing, you said, and I quote, "I do not want to be back here in a few years discussing how we can dig ourselves out of yet another postal crisis." And I totally agree with you, but I am afraid this bill would guarantee that result as written.

The legislation we need must make sensible reforms to reduce the unfunded liability of postal retiree health benefits. It must eliminate the Postal Service's debt with surplus pension funds and adopt reasonable pricing and product reforms without attacking our invaluable networks and productive workforce, which are both essential to our future growth.

There are many good policy alternatives to austerity and downsizing. I urge you to consider the proposals that the NALC has put forward in our written testimony. We do pledge to work around the clock with all of you and all of the other major stakeholders to strengthen and to protect the United States Postal Service.

I thank you for the opportunity to testify.

Chairman CARPER. Thanks very much, and thank you for your leadership and for your willingness to try to work with us and all the other stakeholders to get to a place where this Postal Service could be vibrant and just a real linchpin of our economy for a long time to come?

Mr. Hegarty, please proceed.

TESTIMONY OF JOHN F. HEGARTY,[1] NATIONAL PRESIDENT, NATIONAL POSTAL MAIL HANDLERS UNION

Mr. HEGARTY. Thank you, Chairman Carper.

Chairman Carper, Dr. Coburn, Members of the Committee, on behalf of the National Postal Mail Handlers Union, I appreciate the opportunity to testify here today to present our views.

My union represents more than 45,000 craft employees, most of whom work in the Postal Service's large processing plants, such as the one that I come from in Springfield, Massachusetts. Processing is time sensitive and labor intensive. Further reductions in the number of processing facilities or in the hours worked by mail handlers will have a dire impact on the timely processing and delivery of all classes of mail. This is especially true for mail items that need prompt processing and delivery, such as priority, express, or first-class mail, and also medicines from pharmacy companies, newspapers, magazines, and advertisements.

The Postal Service has faced some severe economic conditions since 2007. To the extent that the Postal Service has had to downsize because of the Great Recession of 2008 and the decline in mail volume, that downsizing has already occurred. Three hundred processing plants have been eliminated in the past 5 years, and the employee complement has been reduced by more than 300,000. Postal employees have already contributed to and sacrificed for the financial turnaround of the Postal Service. My members have had their wages frozen for the past 2 years and employee contributions have increased for both health insurance and retirement.

About 20 percent of Postal employees, including more than 5,000 members of my union, are working in non-career, part-time jobs at reduced pay rates. And thousands of employees have been involuntarily excessed or transferred to other work locations, often hundreds of miles away, and have had to uproot their homes and their families because of the closings and consolidations of the postal network.

Last week, the Postmaster General testified that the Postal Service has reduced costs by $16 billion during the past few years. As a labor-intensive service industry, it should be clear that most of those savings have come from Postal employees.

A fair estimate is that the recent bargaining agreements have contributed $12 billion to the Postal Service's expense reductions. The question to be asked, therefore, is: What have the other stakeholders contributed?

First and foremost, it is now time for Congress to take action. Most of the losses announced by the Postal Service over the last few years have nothing to do with a failing business model or the obsolescence of the mail. In 2006, Congress mandated that the Postal Service prefund future retiree health benefits and do so 75 years into the future, but do so within 10 years. We all know about

[1] The prepared statement of Mr. Hegarty appears in the Appendix on page 512.

the prefunding. The Postal Service now has $49 billion in that account.

The facts are even brighter with regard to retirement. The Postal Service not only is fully funded in its retirement costs but, in fact, as we heard earlier, has overfunded their share of the Federal Employees Retirement System. Congress needs to act immediately to adjust the FERS account using postal-specific data and return the overpayments.

Nor should there be any severe restriction on how the Postal Service should use these monies. It should be allowed to pay down some of its debt and invest in programs and technologies to grow the business.

With all respect, S. 1486 does not properly deal with both of these issues. On retiree health, the bill does not eliminate the remaining prefunding requirement but, rather, defers these unaffordable payments until 2016. Although the bill reduces the overall funding to 80 percent of total liability and allows for the payment of current retiree health premiums and the retiree health fund, the annual payments that would be required from the Postal Service starting in 2016 actually might exceed the obligations under the current law.

With regard to pension, the draft bill unacceptably caps the FERS refund at only $6 billion. S. 1486 also fails to require an accurate calculation of the postal surplus attributable to the Civil Service Retirement System in the manner reasonably proposed by S. 316, which has been introduced with 31 Senate cosponsors.

In one of its most unjustified provisions, S. 1486 would subject the continuation of Federal health and retirement benefits for Postal employees to future negotiation and arbitration, thereby threatening the future solvency and stability of the entire Federal Health Benefit Program and threatening to single out new Postal employees for grossly unfair treatment on the subject of employee benefits.

This bill is also deficient on issues relating to the maintenance of service by the Postal Service. After a 2-year moratorium, S. 1486 would allow for the continued dismantling of the mail processing and delivery network that has always been the backbone of the Postal Service. Allowing the Postal Service to reduce service standards or eliminate days and points of service will only lead to lower quality and slower service. This would cause additional losses in business from mailers and the American public, which in turn will lead to deeper cuts and a continuing crisis.

We also see no reason that the major mailers and the mailing public should not be asked to contribute their fair share to the future success of the Postal Service, perhaps by loosening the cap on rates to something more than the Consumer Price Index or by measuring inflation with another index that more realistically reflects the cost pressures faced by the Postal Service.

As currently drafted, S. 1486 also contains a wholly unjustified reduction in workers' compensation benefits. The legislation would penalize injured workers with the worst injuries by forcing them into a retirement system that is based on their final salary, even though they were prohibited from earning increases in salary because of their on-the-job injuries. These workers also would be unable to save through the Thrift Savings Plan or earn Social Security credits while receiving workers' compensation. These provisions need to be removed.

Finally, let me address the Postal Service's proposals to change its retirement and health insurance programs.

With regard to retirement, there is no basis whatsoever for the proposal to leave the FERS system and adopt a separate defined contribution program. As already noted, retirement obligations are fully funded, if not overfunded, and do not impose any burden on postal finances.

As for health insurance, the Postal Service continues to call publicly for a USPS-only health plan, but that proposal is inconsistent with my union's guiding principles on health care for our members and other postal employees.

First, we insist that the Postal Service remain part of the Federal Employees Health Benefit Program to ensure the continued success of that program and to take advantage of the size and bargaining power of the Office of Personnel Management.

Second, we insist that our members continue to have a wide range of choices in health insurance plans so that individual employees can choose which plan is best based on their family situation and other circumstances, just as all other Federal employees are allowed to do.

Thank you again for allowing me to testify. I would be happy to answer any questions.

Chairman CARPER. Let the record show you used every second of your time except the last 2 seconds.

Mr. HEGARTY. I watched the clock.

Chairman CARPER. That is pretty good timing. All right. Thanks. Thanks so much.

Mr. Rapoza, please proceed.

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

Mr. RAPOZA. Chairman Carper, Ranking Member Coburn, and Committee Members, thank you for inviting the National Association of Postmasters of the United States, to testify today. I will once again seek to provide constructive input. For the record, I am currently serving my 47th year as a Postal employee and very proud of it.

In my February 2013 testimony, I identified the core elements that Postmasters believe must be part of postal legislation, and they include: Promoting revenue generation through innovation and credible pricing; funding retiree health benefits and pensions fairly and realistically; and preserving universal service.

Mr. Chairman, I concluded my February testimony with the admonition: "The future of the Postal Service is in your hands." And you amended my remark by commenting: "The future of the Postal Service is in our hands." I agreed. So, let me share with the Committee some of the sacrifices endured by Postmasters, which have contributed to Postal cost reductions.

[1] The prepared statement of Mr. Rapoza appears in the Appendix on page 520.

Postmasters have been denied merit-based salary adjustments for the past 3 years. Postmasters are not entitled to cost-of-living-adjustments. Five thousand full-time Postmaster positions were eliminated over the past year. Another 4,500 will be eliminated by September 2014, and more than 6,000 Postmasters will shoulder the burden of overseeing multiple part-time post offices, with strained resources and limited training.

It is also important to note that the non-career postal employees, known as Postmaster Replacements (PMRs), who will staff most of these part-time post offices, are not afforded employer-provided health benefits. However, we hope that the Committee can address the unmet health needs of the PMRs.

Additionally, beginning this year, Postmasters will absorb an increased share of their FEHBP premiums. Even with these sacrifices, Postmasters continue to maintain a strong commitment to postal-reliant communities. So, Mr. Chairman, I think it is crucial to understand that Postmasters continue to do our part on behalf of the Postal Service and its future.

Now let me summarize NAPUS positions on certain provisions of S. 1486. Section 301, provides more expeditious rate adjustments and pricing flexibility. Indeed, the hard CPI cap has proven to be injurious to postal operations and finances; moreover, the cap has not stemmed the tide of mail leaving the postal system. We believe that Section 302 of the legislation provides the Postal Service with essential latitude in developing innovative products and services and commend you for its inclusion.

The Postal Inspector General called upon the Postal Service to leverage the Postmasters' community status by encouraging Postmasters to join local civic associations, providing fertile ground for marketing postal products and services. This should be included as part of an effective strategy to market the products and services. It could very well be a better investment than having a contract with a company like Faith Popcorn's Brain Reserve for an hourly rate between $91 and $836.

While NAPUS could support some of the sections that address issues that moderate Postal Service employee benefit obligations, others raise red flags. Section 101 would provide a refund of up to $6 billion that the Postal Service has provided on behalf of its FERS beneficiaries. While we can agree to this provision, NAPUS believes that if the overpayment exceeds $6 billion, the higher amount should be reimbursed to the Postal Service.

Section 102 would permit the Postal Service to deny newly hired Postal employees the opportunity to participate in FERS. It is unclear from the language how Postmasters would be treated under Section 102, since we do not collectively bargain. Moreover, it is unfair to put at risk the assurance and stability of retirement benefits for future Postmasters by eliminating statutory retirement protection.

Section 103 would restructure the Postal Service's retiree health prefunding schedule to make required payments more manageable. While NAPUS believes that Congress should revisit the obligation in its entirety, amortizing 80 percent of the projected liability over a 40-year period, beginning in 2016, is a step in the right direction.

Let me state for the record that I represent the only employee organization at this table that does not collectively bargain or sponsor an FEHBP health plan. Section 104 would subject employee health coverage, not just the Postal Service premium contribution, to collective bargaining. Postmasters currently have the opportunity to consult over benefits, not bargain over them.

NAPUS is also concerned about the uncertainty of continued comprehensive health coverage for Postal retirees, particularly for those who are not Medicare eligible. It is also unclear how the voluntary separation of Medicare eligibles will impact Postal employees and retirees who are not Medicare eligible.

In conclusion, NAPUS is concerned with the thrust of a number of the provisions that impact Postal employees' and retirees' statutory health and retirement benefits. Nevertheless, NAPUS continues to be willing to discuss the future of postal health benefits, so long as such coverage remains within FEHBP and the interests of our members are protected.

We are also concerned about the decision to omit specific provisions that were included in S. 1789 that helped assure postal accessibility to all Americans. We are supportive of those provisions that make the retiree health prefunding schedule more manageable and provide the Postal Service with opportunities for innovation, encouraging governmental partnerships and enhanced pricing flexibility.

I thank you, Mr. Chairman, and NAPUS is committed to working with you and your Committee and the Postal Service to cross that goal line that we talked about in February.

Chairman CARPER. Thank you. Thank you for that testimony, and thank you for 47 years of service to our country. You have been serving us through the Postal Service for longer than most people in this room have been alive, and we are aware of that and grateful for your service. Thank you.

Dr. Holtz-Eakin, it is great to see you. Do you still enjoy testifying before Congress? I know you do not do it quite as much as you used to when you were CBO Director, but do you enjoy it?

Mr. HOLTZ-EAKIN. I both enjoy it and think it is an obligation. It is a kind of public service and something——

Chairman CARPER. You are good to do it. We appreciate it very much. Thank you.

TESTIMONY OF DOUGLAS J. HOLTZ–EAKIN,[1] PH.D., PRESIDENT, AMERICAN ACTION FORUM

Mr. HOLTZ-EAKIN. Mr. Chairman, Senator Coburn, and Senator Johnson, thank you for the chance to be here to discuss postal reform. This is an issue that I worked with this Committee on as far back as 2004 when I was at CBO and when I heard there were deep concerns about the financial outlook for the Postal system. And I can say that it is in far worse shape than we envisioned at that time, and I sympathize with the job you have in front of you. It is a quite difficult problem to solve.

In light of the fact that only 10 years ago we missed it by a fair amount in the work we did, I guess I would emphasize something

[1] The prepared statement of Mr. Holtz-Eakin appears in the Appendix on page 535.

that came up in the first panel, which is the sensitivity of many of the numerical conclusions and, thus, the structure of the solution to assumptions. The discount rate got highlighted by Senator Johnson. I worry about the projected growth of health care costs in a lot of these actuarial assumptions because that historically has bounced around a lot, and it is at the heart of the Postal system's financial problems. Right now we are having a relatively modest growth in health care costs. That has happened before, and it has gone away. I believe there is reason to worry about upside growth in the health care costs, and that will make all these problems more difficult. I would design solutions that are as robust to that as you can, I would say, the only admonition I would bring to that.

With respect to the rest, I think everyone would agree that the heart of the solutions are in changing the fundamentals, changes to the scope of activities, the volume of those activities, and what the Post Office can charge for them. That is going to improve the revenue outlook and, the real subject of today, what happens on the cost side, what are the quantity of facilities and equipment that have to be financed, at what capital cost, and in particular, how many workers, what is their productivity, and what is the compensation cost.

Some things contemplated in the bill will change those. New types of retirement plans that are not FERS could change lifetime compensation costs, fundamentally alter the outlook over the course of the future. Those I think are to be focused on. Some of the rest, as has been mentioned, amount to shifts in costs over time or across people, and how you think about them I think really comes down to how you think about the Post Office as either part of the government or as a stand-alone entity in the two extremes.

If it is part of a government pool, insurance pools for retirement or health inherently involve redistribution from person to person or agency to agency. That is part and parcel of insurance. If so, then those shifts are something everyone should accept and not worry about. They are part of financing a government pool of benefits.

If you think of it as a stand-alone entity, then, in fact, in FERS perhaps there has been overpayment. That would be refunded and not replicated in the future. You might think differently about the shifts from Medicare and FEHBP. So that is really a decision the Committee has to make about what is the vision of the future of this entity. But some of them, I think, are—there are two other aspects that I think are important. One is sometimes you change the fundamentals. I would be concerned that if you shift more people to Medicare, which has a history of high volume and non-managed activities, you will actually change the fundamentals. You will spend more. It is not just who picks up the bill and which accounting it goes through. And I would pay attention, again, to fundamentals. You do not want costs going up. You want them going down.

And the second is because the post office is such a large fraction of, in particular FEHBP, a system that has often been held up as a model for future reforms, that you do not do back-door FEHBP reform in this bill, that you be careful to make sure that the system itself is either reformed in its own right, where I think there is some case to be made, but at least not damaged by the postal reform.

I am happy to be here today. I look forward to any help I can offer.

Chairman CARPER. Good. Thanks so much for that testimony and for joining us as well.

Dr. Baker, welcome. Good to see you.

TESTIMONY OF DEAN BAKER,[1] PH.D., CO-DIRECTOR, CENTER FOR ECONOMIC AND POLICY RESEARCH

Mr. BAKER. Thank you, Chairman Carper and Ranking Member Coburn, for inviting me to testify. I appreciate the opportunity to address the Committee.

I want to make two main points, which, of course, have come out, I am sure, in the earlier panel, which I am sorry I missed. It was an overcrowded room. I would have been here otherwise, but I could not find a place to comfortably situate myself. But I would like to make, first off, the point that the pace of buildup in the retiree health care fund is certainly extraordinary and, as has been pointed out, is much of the source of the losses that the Postal Service has incurred in the last decade.

The second point is that the treatment of the Postal Service continues to be very asymmetric with private sector firms, and if the goal of Congress is to try to treat the Postal Service in the same way that we would expect a private sector firm to operate, we are still very far from that, and particularly what I want to emphasize is the treatment of the retiree benefit funds.

On the first point, the Postal Accountability and Enhancement Act passed in 2006, which required a very ambitious pace of prefunding for the retiree health benefit system. I understand the intention of Congress. The goal, of course, was an admirable one: To ensure that the taxpayer was not stuck with the bill in the event that there was a sudden crisis and, the Postal Service would have to suddenly make good on these obligations. And prefunding, arguably, is a reasonable goal.

It is worth noting that this is generally not done in the private sector. We are seeing firms rapidly move away from having retiree health benefits, but in those that do, you will find very few, if any, that have full prefunding. So this is extraordinary, and it was also an extraordinary decision to go ahead and do that over a 10-year period. The numbers speak for themselves. We are talking about a rate of prefunding on the order $5.5 billion a year, which is about 8 percent of the Postal Service's revenue. So that is a very heavy burden to have imposed on any business, and certainly the Postal Service had a very difficult time dealing with that.

Now, that would have been true even in normal times. Of course, in 2006, Congress did not anticipate the economic collapse that we subsequently saw 2 years later. Very few people did. And it is very unlikely, had Congress anticipated the sort of downturn that we subsequently saw and still find ourselves in today, that they would have made a proposal of putting this sort of extra burden on the Postal Service.

[1] The prepared statement of Mr. Baker appears in the Appendix on page 540.

Now, in addition to requiring a very high rate of prefunding, a very rapid rate of accumulation, I should say, I should also point out that the assumptions involved here are in many ways very pessimistic. Doug had raised the issue about health care costs, and, again, great uncertainty on that. But I look at those assumptions and see them as very pessimistic: 7 percent annual growth in health care costs. I would just point out that we have the recent experience of health care costs growing much more slowly than that. And, again, none of us know exactly what will happen. But it is worth noting that the Center for Medicare & Medicaid Services projects 5 percent per person health care cost growth over the next decade. So in this sense, we are talking about considerably more rapid growth, which has a huge effect when compounded over the projection period. So we would be very far toward meeting that 80-percent target if, in fact, that 5-percent rate persists over the projection period. Again, I am not saying that it will. I am simply saying that it is a reasonable possibility, and we are imposing a very heavy burden on the Postal Service that may not be necessary.

A second point, again, I am sure this came out, but I just think it is striking. I had occasion to be in one of the mediation hearings back in 2011, and I looked at the Postal Service's projection at that time. They were projecting revenue falling to just $63 billion as of 2013 and continuing to decline over the rest of the decade, so it would be about $59 billion by the end of the decade. We are now looking at revenue of $66 billion. So, in fact, there has been really a quite remarkable turnaround. We are looking at a system that does look as though it is quite viable apart from these retiree obligations. So it is not as though we have an ailing system on its last legs. It looks very much as though we have a system that, in principle, is viable but is suffering very much from, I would say at least, an excessive burden in requiring it to prefund at a very rapid rate.

The second point I want to make was that the treatment of retiree funds is certainly asymmetrical with the private sector. Again, there are many ways we could talk about the Postal Service, certainly its lack of flexibility and pricing and product offerings that put it at a disadvantage in many ways relative to the private sector. But it is really quite striking if you look at its prefunding requirements. Specifically what I am simply saying here is its requirement that it invest its funds exclusively in government bonds. Again, I understand the rationale for that. Obviously if they were to invest in other assets, it would involve an increase in the deficit as ordinarily reported. But, nonetheless, that is a very real handicap. I just did some quick calculations, very simple calculations. If you simply assume that the funds—and here I am talking about all three funds: CSRS, FERS, and the Retiree Health Benefit (RHB) Fund. If all three had been invested in a diversified portfolio offering a 7-percent nominal rate of return, the difference between that and investing in government bonds would be about $6.6 billion in the current year. If we assumed an 8-percent nominal return, slightly higher but still consistent with what is assumed in many pension funds, the difference would be about $9.9 billion. So this is very large relative to the operating income of the Postal Service, and it would make a very big difference.

Now, again, I understand it would not be easy to talk about switching, particularly in the case of CSRS, which is probably just about impossible to switch into a diverse portfolio, but it is something that I think Congress has to take into account if there is an expectation that the Postal Service is going to compete with private sector competitors who do, if we look at UPS, in fact invest a pension fund in a diversified range of assets.

So, in conclusion, what I would just say is that I think the Postal Service is clearly a viable, ongoing entity, and I understand it is the intention of the Committee and the intention of Congress to keep it as such. And I think it has to be mindful of the handicaps that it has placed, obviously unintentionally, with what I would consider an excessive prefunding requirement with its health care fund.

Thank you for listening.

Chairman CARPER. Thank you all. Taken together, that is very constructive and I think helpful testimony, and we welcome every bit of it.

Dr. Coburn and I do not agree on every single thing, but one of the things I think we are pretty much in lockstep on is the need to reduce our Nation's budget deficit. And I focus on three areas, as I said earlier on, and one of those is we need entitlement reform that saves these programs, saves them for the next generation, saves money, and also does not savage old people or poor people. That is No. 1.

No. 2, we need tax reform to generate some revenues to go toward deficit reduction.

And, No. 3, we need to look at everything we do, everything we do in the Federal Government, and ask this question: How do we get a better result for less money in literally everything that we do? And the same is true here with respect to health care coverage for Postal employees and for Federal employees.

When I was Governor, they let me be Chairman of the National Governors Association (NGA) for a while, and after that they let me be the Chairman in the National Governors Association of something called a "Clearinghouse for Good Ideas." We had a Center for Best Practices, and all the States, all the Governors, would share ideas that worked with other Governors. And we used to say there are 50 States, there are 50 laboratories of democracy, let them go forward and experiment. And then the rest of us will learn for better or for worse from those experiments.

Do we have the opportunity here, if somehow our friends from organized labor, from the Postmaster, from Postal management, if they are able to come up with a way to get, if you will, better health care coverage for a little bit less money could that not be like one of 50 laboratories to experiment, but an experiment? Could it be a good, viable experiment for us as we consider everybody else that is in FEHBP? That is my question. Let me just direct that first to Dr. Holtz-Eakin and then to Dr. Baker. Could this be a good opportunity to experiment so we might learn for the rest of the Federal Government, how to get better health care coverage for less money or the same amount of money?

Mr. HOLTZ-EAKIN. I certainly think so. There is no reason to believe that when FEHBP was invented 40-odd years ago that Congress got it right by legislating for specific designs, with all due respect. Some things have changed a little bit. So, yes, there is a good case to be made for reforming FEHBP, and there is a good case to be made that this is a place where you could try some things out. No doubt about that.

Chairman CARPER. Thank you. Dr. Baker.

Mr. BAKER. Certainly, I would just mention one—well, two points I would make.

First off, I would like it to be voluntary on the part of—because, in principle, we want something that would both benefit the beneficiaries and save the government money.

But, second, in terms of, nothing is ever simple. Something that can be done, we do have a health care system just north of us in a country called Canada where costs are about half as large, I guess about 60 percent as large as the United States', which should start raising an obvious point that, if we could get people, say, in a neighboring State, in Washington State, in Maine—we have lots of areas of the United States that are close to Canada, Michigan where I spent many years. If we could arrange for a situation where people could buy into the health care systems in Canada and split the savings with the U.S. Government, that could be very much a win-win. And, again, if you gave people the option, they are not forced into that, if someone in Michigan opts to take advantage of the health care system across the river in Windsor, that could be a win-win for everyone involved.

Chairman CARPER. All right. Thank you.

I am a glass-half-full guy, and I am a glass-half-full with respect to better containing the growth of health care costs in this country going forward. A lot of people say, well, it is Obamacare, the reason why we have seen a slowing of health care costs. It is the Affordable Care Act. I think it has helped, but it is not the only thing. We are doing a lot of smarter things in this country in delivering health care costs: electronic health records, federally qualified community health centers where we reduce the number of people who show up in emergency rooms sick, really sick, get hospitalized. They now go to their community health center; get better access to prescription medicines; the idea of coordinating delivery of health care and providing medical homes; the idea of giving everybody in every State in the country the opportunity to participate in a large purchasing pool, an exchange or marketplace for health care. All those things that are new—and some are not new ideas, but they are actually being implemented—I think they have the potential for really helping us continue to rein in the growth of health care costs. And that 5 percent that I think you cited, Dr. Baker, I think that is not an unrealistic number.

I want to come back to something, Fred, that you said, and I tried to write down part of it. You said, "Congress should focus on the elephant in the room: The prefunding of retiree health care liability," or words to that effect. Tom Coburn and I have really tried to do that. We really have tried to do that. And if you look back at what we did in 2006, the only way we got President Bush to sign the bill was to agree to this unrealistic, overly conservative approach to prefunding retiree health care. At the time I did not think it was a good idea. I am not sure that Senator Collins, thought it was a good idea. That was the price for admission. That was the price for getting the bill signed into law.

And what we have done in our legislation—let me just be real clear. What we have done in our legislation—the $40 billion that has been prepaid to meet this retiree health benefit? We provide to the Postal Service the ability to access that money to pay for retiree health care costs. And we do not say you have to meet the rest of the liability. We do not say you even have to amortize the liability, the remaining liability for retiree health care costs over 40 years 100 percent. We say 40 years, 80 percent.

But I will tell you this: It would be interesting if we could actually look at every county, city, and State in this country and see how they propose to amortize their liability for their retiree health care. My bet is that nobody has an approach that is even that fiscally responsible, that responsible.

So we really have tried hard on this. We have really tried hard on this, and I am disappointed to hear you suggest that we have not.

Let me just go to Mr. Hegarty and Mr. Rapoza. Your response to that, if you will. Have we been as delinquent on this as Mr. Rolando has suggested? Then I will ask our other two witnesses as well. We have tried to be responsible.

Mr. HEGARTY. Yes, well, I thought you were directing the question to Mr. Rolando——

Chairman CARPER. No. To you.

Mr. HEGARTY [continuing]. But that is fine. No, we appreciate your efforts on this. Do not take it that we are saying that you have not done anything on it. We just have a difference of opinion on the funding schedule going forward. Some facts and figures out there would suggest that 2016, 2017, 2018, and farther out, the liability will actually be more per year than it is now. In other words, now it is $5.5 billion. In 2018, it might be $5.8 billion because it has been re-amortized.

I appreciate the 80 percent. I appreciate the 40 years. I think it is a step in the right direction. But as you heard the Postmaster General testify earlier, we are trying to come up with a plan—and we are not there yet so I cannot give you too many details, but he alluded to it—where we can save the Postal Service the money on health care and eliminate the prefunding going forward.

Now, it has been said that we are going to be overloading Medicare or adding costs to Medicare. I have been paying into Medicare my whole adult working life. When I retire, I want the benefit of those payments. So that is a promise that the government made to me: If you pay your Medicare taxes, you will have Medicare when you retire. I do not see that as being unreasonable that Postal employees should—the 23 percent who are not currently taking advantage of Medicare, that they should not be encouraged to take advantage of Medicare, Part B.

Chairman CARPER. I think it is fair to say Dr. Coburn and I think it is an inequity. What we have right now is an inequity. Folks pay into Medicare, but the Postal Service, their employees, retirees, do not have the full benefit from that.

Mr. Rapoza—and I know I am over my time. Let me just go to you, please.

Mr. RAPOZA. NAPUS looks forward to working with the Committee. We worked with you on S. 1789, and we look forward to working on S. 1486. And when we testified on February 13, I think you mentioned that we were in a red zone on the 20-yard line.

Chairman CARPER. Yes.

Mr. RAPOZA. I did not know we had 80 yards to go. I thought we just had that 20 to go. I guess we were on the wrong side of the 50-yard line. But we are kind of frustrated that it keeps going up. But we appreciate all you are doing because you have a lot of other things on your plate. And I think this morning was the first time I have seen almost the full Committee here sitting down. So there is a lot of focus on this, and we appreciate what you are doing.

I do think that a fresh look at the liability is warranted and the members that I represent are concerned on the Medicare issue also. We are concerned by the unknown. But the Postal Service has been very open with us. We have forwarded them 19 questions. They have returned answers. So we are communicating with the Postal Service. The biggest fear is trying to get to the unknown.

For us, the other fear is not having power to negotiate. We consult, yet we do not have collective bargaining. So where do we fit in on this? And that is the part that we are willing to work with.

Chairman CARPER. Just a brief comment from Dr. Holtz-Eakin and Dr. Baker, and then I will yield to Tom.

Mr. HOLTZ-EAKIN. You cannot separate the prefunding from the rest of the issues. Those are costs that are going to be paid now, or they will be paid later, paid out in a schedule that you laid out in the legislation. But by spreading them out longer, you are buying time to fix the business fundamentals, and it will only be a good idea if you fix the business fundamentals and never forget that.

Chairman CARPER. Thank you.

Dr. Baker, just briefly.

Mr. BAKER. Yes, just quickly I would say that as I am sure you recognize, this is a very serious burden if you are to take any business, even a thriving one like Apple or Amazon, and say, OK, we made an accounting mistake, you have to pay 8 percent of your revenue into X fund, that would be a huge burden that would jeopardize even their viability. So I think we have to recognize that.

Chairman CARPER. Good. Thanks. Tom.

Senator COBURN. Yes, I would just note for the record, according to Congressional Research Service (CRS), 25 percent of private companies prefund their retirement health care. So the fact we say that not very many people do that is inaccurate. Twenty-five percent do. Some are through the Voluntary Employee Beneficiary Association (VEBAs), some are not. But, in fact, 25 percent of private companies.

The second point that I would make, private companies have to list their unfunded liabilities for their retiree health care as a liability on their balance sheet. We have an organization, the Postal Service, that has twice as many liabilities as it has assets right now. And that is without listing retiree health benefits in it.

So the point is it goes down to this: We have an obligation to keep our word to the retirees of the Postal Service, and I take what Dr. Holtz-Eakin said. Nobody can predict what the future health care costs are. But the trend, until we have a truly transparent, competitive market in health care, which we do not have today—we did not have it before the Affordable Care Act, and we do not have it today. Until we have transparency and true markets on health care, where individuals make the best choice for them and their family, we better err on the conservative side on the cost pressures on health care.

I am absolutely committed to the workforce of the Post Office to make sure that every commitment that has been made to their employees on retiree health benefits is kept. And what we have to do is find the sweet spot that you all are agreeable with that still meets the reality test.

I have one other question. Your comments, Mr. Rolando, on the Federal Employees Compensation Act, just to remind you, those who are permanently totally disabled and unable to work under this bill would be exempt from this section. They are grandfathered. They are totally grandfathered. We have numerous people over 90 years of age collecting workers' compensation from the Post Office rather than their retirement. And I understand the differential there, that because they were injured, they could not go back and earn more through time. I am not fighting that. I am actually open to allowing people on that to continue to participate in FERS. I do not have any problem with that. But we still have to reform the system because it is totally unaffordable and we have gone from $7 billion to $17 billion in 6 years in terms of—so what we have to do is look at every aspect, and that is what Senator Carper and I have tried to do with this bill. And we knew we were going to get tons of criticism. That is why we are having this hearing. We want to get the feedback.

I want to assure you that our commitment is firm, that one is we get pricing capability at the Post Office. Now, we may not win it the way we would like to do it right now, which we think is important. It needs to be market based. It needs to be sweet spot based. You do not want to run away your business. But you also do not want to subsidize business to a degree greater than it has to be subsidized to keep it. And we have to keep our commitments in terms of the promises made to retired Postal workers.

And then we have to have the regular negotiations that you all are good at to get the best benefit you can given the political realities and the financial realities of the Post Office. So that is what we are trying to do.

Mr. ROLANDO. May I respond?

Senator COBURN. Sure.

Mr. ROLANDO. On the workers' compensation, I agree with you, I think it is important that any workers' compensation program ensures that a worker, because they are injured is no better off or no worse off as a result of the benefits that they are able to get rather than retirement. I think the issue with the provision is that the data and the research that was done by the Department of Labor was not done in FERS employees. It was done on Civil Service employees, who are pretty much gone. I mean, we have less than 10 percent Civil Service. There was no data run on the FERS employees.

If you compare FERS employees to the benefits, they are already worse off with the workers' compensation benefits, and this bill would take them even further down. But as far as the equality you are talking about, we are all for that.

Senator COBURN. But I would also tell you, in the private sector nobody stays on workers' comp in the private sector at retirement age. They go to the retirement.

Mr. ROLANDO. Sure, and we agree in equity that would be great if we had a bill that did just that with no loss, no gain.

Could I also comment on what you said, if you have time, on the prefunding? Because we mentioned 25 percent of the companies—and I agree——

Senator COBURN. That is not my data. That is Congressional Research Data.

Mr. ROLANDO. Sure. I think it is correct. We are all for the prefunding. We just think there are maybe like four ways you do it. Either you have beaucoup profits and you can just do it, which would be great at 100 percent, 75 years in the future. That would be wonderful.

Or as I mentioned, if we had some surpluses, if they were recognized, all those things we talked about, if you could do it that way, that would be wonderful.

A third way, as you mentioned, the corporate practice is 25 percent of the companies that do it, but they do it at an average rate of 35 percent, not 100 percent. If we mirrored that.

The fourth way would be to find a way to bring the liability down, which we have all spoken to, to some extent. Of course, the NALC would be all for figuring out a way to do that so it does not, of course, compromise the networks and the workers and so forth. There are ways to do that.

Senator COBURN. Let me ask you a question. Would you all be interested at all from a bargaining standpoint in having a VEBA and you run your own health care?

Mr. ROLANDO. That is a tough question.

Senator COBURN. Well, would you think about it and reply to me?

Mr. ROLANDO. Well, at this point——

Senator COBURN. I do not want to put you on the spot.

Mr. ROLANDO. At this point, what we are really looking at and we are in discussions with the Postal Service, the other unions, the mailers, we are all looking at all these Medicare provisions and how that would work as part of a more comprehensive reform that includes the things that really need to be done without compromising the networks and the workforce. We have been in pretty deep discussions about that.

Senator COBURN. So it is important to put back into the record. If you include employee health benefits, the benefit package for the average employee of the Postal Service, excluding management, is $35,000 a year. That is the benefit package. That is the cost of the benefit package. And that is 3½ times what the average private sector benefit package is.

So those things need to be put into perspective in terms of if we are going to be competitive. And I would make this point, and I think Dr. Holtz-Eakin has. It is not just the Postal Service that is wrestling with health care costs, right? I mean, the charade we have seen this week is about health care costs ultimately and how do we stay competitive as a Nation. Your comments about up north, I would differ in terms of the same health outcomes, but there is no question it is lower. Plus we have six studies that show $1 out of every $3 we spend in this country does not help anybody in health care, and I think that is market force related, because we all think somebody else is paying for our health care. And anything we can do, you all can negotiate with the Postal Service, that gives you the same health care at a lower cost ultimately benefits you not just in your health care but benefits you in terms of the future of the Postal Service. And that is why I think some of the ideas that the Postal Service and the unions are working on are going to be very beneficial. And I would also say you ought to share in some of the benefits of that.

And so we have a lot of things we need to do. I will submit to each of you some questions for the record, if you would get back with me on those.

And I have never held a job longer than about 9 years, Mr. Postmaster, so I would congratulate you again on the number of years you have done.

Chairman CARPER. But he has always had a good job.

All right. Senator Johnson.

Senator JOHNSON. Thank you, Mr. Chairman.

Chairman CARPER. And I want to say again—I always say this when he comes. Along with Dr. Coburn, he is a faithful attender of these hearings, and we are deeply grateful.

Senator JOHNSON. Well, I learn a lot, and these are important issues.

Let me just chime in on my own opinion in terms of what is happening with the moderation in the rise of health care costs, having been purchasing health care for the last 31 years. I think the increase in deductibles over time, the advent of the Health Savings Account (HSAs) have actually begun reconnecting the consumer to the product, the payment to the product. I think that has gone a long way toward just starting to restrain costs, which was one of my big problems with the health care law. And then just the poor economy, that always depresses prices across the board. So I think those are the two primary factors.

Mr. Rapoza, there are a couple statements I just need to talk to you about. You talked about misinformation, outdated models in terms of calculating the liabilities. I personally think the elephant in the room here really is the GAO testimony that shows on their Table 1 an unfunded liability in total of $96 billion, basically $99 billion less a $3 billion surplus in FERS, which is what we are all talking about this prefunding.

Mr. Rapoza, you talked about being concerned. If I were a Postal worker, I would be concerned about that $96 billion unfunded liability. What am I missing here?

Mr. ROLANDO. Were you referring to pensions or retiree health care?

Senator JOHNSON. I am talking about the entire liability having to do with pensions and health care. Again, I know you can pick and choose the little individual section, but if I am a retired Postal worker, I would be kind of concerned about the overall package that I have been promised and the financial stability of the Postal system to make those payments?

Mr. ROLANDO. As a Postal worker, if I am Civil Service, I am pretty comfortable because I am 100 percent funded for my retirement. If I am a FERS enrollment, I am pretty comfortable because we are 100 percent or overfunded in that retirement system.

As far as my retiree health care, the Postal Service has been making the premiums for 50-some years, continued to do so, and they have $50 billion in account to continue to do so.

Senator JOHNSON. So do you just reject that $96 billion unfunded liability in terms of——

Mr. ROLANDO. No. I am proud to work for a company that is more funded than any other company in the country for their retiree health benefits.

Mr. HEGARTY. Senator Johnson, we do not have the tables in front of us, so I have not seen the $96 billion liability. But we would be happy——

Senator JOHNSON. OK. I would really suggest you take a look at that GAO report.

Mr. HEGARTY. Yes.

Senator JOHNSON. That is certainly what would concern me.

Mr. Rolando, you also talked about that the losses are clearly—they have nothing to do with the lost revenue, but in 2007 revenue was about $75 billion, now it is about $65 billion, is what I get. That is a $10 billion drop. Whereas, operating expenses have been reduced, but it is $3 billion. So operating expenses, 80 percent of which are labor, I mean, isn't that the primary cost driver, and isn't really what the Post Office is struggling with is a different, dramatically changed business model where we are losing paper mail and they are having to grapple with that problem?

Mr. ROLANDO. Well, that is a two-part question. I think that the percentage might be correct, but I do not believe the Postal Service is struggling with it at all. We are very labor intensive. We go to every house 6 days a week all over the country with additional addresses added every year. So, of course, a large percent of your costs are going to be labor. The percentage used to be in the mid-80s. It is now in the high 70s as a result of——

Senator JOHNSON. But then, again, isn't that the main driver in terms of the financial situation of—again, I think it is——

Mr. ROLANDO. Sure.

Senator JOHNSON [continuing]. Misleading to keep banging on this prefunding of a liability that is, let us face it, pretty sensitive to just the assumptions, and that surplus can go away in a second based on the changing assumptions of those models.

Mr. ROLANDO. It is one of the——

Senator JOHNSON. Also, by the way, what is the incorrect calculation on those? I mean, you are saying it is an outdated model. How should it be calculated? What is wrong with the model in terms of the calculation of the liability?

Mr. ROLANDO. Your first question, I believe the labor is a positive factor because of the productivity gains.

The second question, the model you speak of, were you talking about the workers' compensation model?

Senator JOHNSON. You said that the calculation of the liability is based on outdated models, and they have to modernize their calculation models.

Mr. ROLANDO. Oh, OK. You are referring to the Segal and the Hay reports with regard to the actuarial reports of the——

Senator JOHNSON. Yes, whatever you were talking about.

Mr. ROLANDO [continuing]. Pensions? OK, yes, that is what we were talking about. Again, I am not an actuary, but the independent reports indicated that if you use—and the GAO themselves said all of those methods were acceptable methods. It was just a matter of a policy decision by the Congress.

Senator JOHNSON. Dr. Holtz-Eakin, could you chime in on that?

Mr. HOLTZ-EAKIN. I have not seen the Segal report. I am happy to look at it and get back to you.

Senator JOHNSON. OK. I mean, do you question the GAO calculations in terms of unfunded liabilities, $96 billion?

Mr. HOLTZ-EAKIN. No, not fundamentally.

Senator COBURN. Let me just caution you. The Segal report has revisionist history in it in terms of what the deal was in 1983 when all the assets were transferred to the Post Office and the obligations were assumed by the Postal Service. So they have totally discounted that in this analysis, which you cannot discount.

Mr. BAKER. If I can comment on the methodological issue, I think the question is whether you take life expectancy specific to the population, to the Postal workers, and I believe those are somewhat less than the overall population. I think that is a methodological issue.

Senator JOHNSON. Again, to me we are quibbling with details when you are talking about $96 billion—what difference would it make? I mean, would it be $93 billion versus $99 billion? We are probably talking about that order of magnitude in terms of the differences based on the calculation, wouldn't we? Nothing significant?

Mr. HOLTZ-EAKIN. Oh, I do not know. I would take a look. I mean, as we know, health care costs have grown faster than any discount rate that is out there in the market for quite a while now, and so when you assume they moderate and how fast they moderate drives the calculation.

Senator JOHNSON. Let me talk a little bit about just average cost of benefits compensation. A couple years ago, when I was running—I saw a study that showed that the average cost for Federal workers was a little over $120,000, average cost, total cost—that is pay and benefit—of the private sector was about $65,000. And you can see just in terms of benefits, $35,000 for a postal worker, $10,000 private sector.

Dr. Holtz-Eakin, can you just comment? How did it get that outsized?

Mr. HOLTZ-EAKIN. I do not have a complete history of the Postal Service. I guess this is why I——

Senator JOHNSON. I am just saying Federal workers in general as head of the CBO, just your comment on that.

Mr. HOLTZ-EAKIN. They are not comparable. Look at the Post Office. It is not a private sector entity. If so, it would be bankrupt. That is what the accounting tells you. It has got a government-provided monopoly for particular lines of business. Monopolies do things very differently, and often they pad their payrolls on top of everything else. We have seen a lot of that. It is true across the government.

So that is why the focus going forward has to be not the timing of this agreed-upon decision to honor the retiree health costs. It is about the business fundamentals, what those labor costs as a labor-intensive industry and what are the lines of business they are going to serve. That is it. If they do not fix that, you do not fix things.

Senator JOHNSON. So coming from the private sector as an accountant, I always had to benchmark my costs, whatever they were, whether it was material costs versus labor costs versus benefit costs, against people I compete with. And that is really what you are talking about in terms of the fundamentals, we have to benchmark what we are paying in total Postal workers versus what the private sector—who they will have to compete against, whether it is FedEx, whether it is UPS. We are going to have to get those costs in line, and primarily with the Postal Service it is labor costs that have to get in line with the private sector over time.

Mr. HOLTZ-EAKIN. And the places we have seen the government struggle the most are those places where new competition has arisen to things that were previously exclusively government monopolies. And that is true here.

Senator JOHNSON. OK. Well, thank you. My time has expired.

Thank you, Mr. Chairman.

Chairman CARPER. Dr. Coburn.

Senator COBURN. I just had one more, and I wanted to hear your response to one of the comments Dr. Baker made about getting a better return on the funds that we have today. For example, when we are investing in T-bills instead of investing in a complex portfolio that is balanced against risk, what would you all think, if you hear a proposal like that where we actually got more bang for our buck on the invested dollars, what would be your position with that?

Mr. ROLANDO. Well, I would not want to put it in timbers or something like that, but I think——

Senator COBURN. That is OK. We do not carve in trees in Oklahoma because we do not have that many. [Laughter.]

Mr. ROLANDO. I do not think it would be a bad idea to look at the different funds in the Thrift Savings Plan where Postal employees already have their life savings and, look at a little better return there, something safe that has some precedent.

Senator COBURN. OK. Mr. Hegarty.

Mr. HEGARTY. I agree with President Rolando. I think the Thrift Savings Life Cycle Funds, whether you look at the L–40 or the L–50, the risk gets spread out over time, the returns would be significantly more than T-bills. I agree with Fred.

Senator COBURN. Dr. Holtz-Eakin, what do you think about that?

Mr. HOLTZ-EAKIN. I am far more cautious. We have been through this war with Social Security, and this line of reasoning is the one that says that, No. 1, the Postal Service gets the upside, taxpayers gets the downside if they do not perform. And, No. 2, if this logic really worked, we should issue, say, $16 trillion more in Treasuries, invest it in the stock market, pocket the difference as the Federal Government.

Senator COBURN. OK. Thank you.

Senator JOHNSON. Could I just chime in on that?

Senator COBURN. Sure.

Senator JOHNSON. Also a couple years ago, as I was running, I did my own little model. I am an accountant. I do spread sheets. And I just took a look at the Social Security surplus. Had we invested that—and I realize these did not exist back then, but a Dow Jones index fund, totally exclusive of dividends, had we done that—and this is a couple years ago, it would be a fair better result today—we would have $5 trillion in a trust fund that was a real asset to the Federal Government. A real assets versus $2.6 trillion trust fund invested in Treasury bonds that has zero value to the Federal Government because they offset liabilities in the Treasury.

So can we do it at this point in time? At some point in time you are better off starting to do the right thing as opposed to doing the wrong thing.

Chairman CARPER. Gentlemen, it has been a real good hearing, and the first panel was very helpful. The second panel, the Postmaster General, you and Ron, I thank you for staying to hear this second panel. They all did a real good job, and I thank my colleagues for being here as well.

I want to just give you each a chance to make a closing statement, 30 seconds, just take maybe half a minute, and, Fred, if you would like to just lead it off, just half a minute, something you would like to leave us with, please?

Mr. ROLANDO. Yes, I want to leave you with one of the last points that was raised because I think it is an important point with an important response with regard to the comparability in the private versus Federal. I would really be interested in looking at that data and sending you a response because I think it is really important to look at apples and apples in there, because it is really easy to look at apples and oranges when you are making a comparison like that. And I would hate to leave that in the record, as was just said.

Chairman CARPER. All right. Thank you. Mr. Hegarty.

Mr. HEGARTY. I would say that, as in my testimony, the cuts that the Postal Service has made so far have basically hit rock bottom. We have lost 300,000 good middle-class-paying jobs. Approximately 25 to 40 percent, depending on category of Postal employees, are veterans. We are losing the opportunities for our returning vets to come back and get a good job with the Post Office like their brethren in years past have done. In the plants, we have cut from over 600 plants, as you stated, Mr. Chairman, to somewhere in the neighborhood of 350, 375 right now.

I am worried that further cuts will erode the business model and not allow the Postal Service to grow and to compete for the business that is out there, and I think it is a cutting mode that should be construed as a death spiral for the Postal Service.

Chairman CARPER. Good. Thanks.

Mr. Rapoza, a closing word.

Mr. RAPOZA. Senator Carper, I want to thank you and the Committee for having this hearing, and I think the sooner we get some postal reform, the more pressure will be released out in the field, not only with staffing but vehicle needs and other essentials out there that we need to provide the service to the American public. So, I would urge you to try to get it done before I leave on December 31.

Chairman CARPER. Yes, sir, that is our goal. [Laughter.]

That is our goal. And then we can name the bill after you, maybe. You never know.

All right. Dr. Holtz-Eakin.

Mr. HOLTZ-EAKIN. Mr. Chairman, I am pleased to see the Senate working on real problems in a bipartisan fashion, and I think it is a wonderful precedent for much of the rest of our government.

On this, I think the thing that I would urge you to remember is that this is not a private sector entity. I am all for giving the Post Office all the tools they need to be successful in the lines of business that the Congress decides they should pursue. But they are ultimately backed by the U.S. taxpayer, and due protection to that exposure is really important in this.

Chairman CARPER. All right. Thank you.

Dr. Baker, please.

Mr. BAKER. I guess I would just make three quick points.

First off, again, looking at the numbers, having not looked at them for a couple years, I am impressed to see the progress the Postal Service has made in restoring itself to profitability.

Second, I am pleased to see the bipartisan interest in considering at least the possibility of a diversified portfolio for the retirement funds, because I think that is—again, if we want to emulate a private business, that is what you would do.

And, last, I hope I get you to consider letting Postal workers get their health care in Canada. [Laughter.]

Chairman CARPER. Let me give the benediction, if I can. The Postal Service announced this week an exigent rate case, and I think they are looking at an increase of as much as 5.9 percent and on an emergency basis. There are about 90 days before us until I think that could kick in. And I think the Board of Governors said upon announcing the exigent rate, they would be happy not to see that take place. I think I speak for most of us on this side of the dais that we would be happy to see that not take place either.

Part of the key, a good part of the secret to making sure that it does not take place, is for us to legislate wisely. We need good input. We have gotten some good input here today. And I know there have been serious negotiations between our labor unions, our friends who represent Postal employees, many of them, and Postal management. If there is a true interest on the part of our friends in organized labor to be able to preserve 6-day-a-week service, I do not know if there is some way that you can negotiate a compensation package maybe for the folks that are delivering on that sixth day that makes this competitive, to do it, and to not do it at a loss.

I know you all have tried to do that before, and I would just ask that you look at that again as you go forward. And I know there is good spirit involved in those negotiations, and I would just urge you to keep at it.

The last statement: I have said before, the situation at the Postal Service is dire. It is not hopeless. There is hope in a hopeless world. And if we have some opportunities here to seize, then I think our goal, my goal is that we ought to seize those opportunities, seize the day. If we work together and work smart, the future of the Postal Service for the next couple hundred years can be almost as bright as it has been for the last couple hundred years.

Again, our thanks to everybody for being here, my colleagues who have joined us today, Senator Johnson who stayed to the not-so-bitter end. And I would say because he has, he will hear this before our other colleagues do: That the hearing record will remain open for 6 days—I think that is until October 4—for the submission of statements and questions for the record.

And with that, the hearing is adjourned, and lunch is served somewhere for each of us. Thank you so much.

[Whereupon, at 12:57 p.m., the Committee was adjourned.]

Opening Statement of Chairman Thomas R. Carper
"Outside the Box: Reforming and Renewing the Postal Service,
Part II - Promoting a 21st Century Workforce"
September 26, 2013

As prepared for delivery:

We meet today for the third hearing we've held this year to consider the financial challenges facing the United States Postal Service, and the second since Dr. Coburn and I put forward a comprehensive and bipartisan proposal to address those challenges.

As I mentioned at our hearing last week, one of my top goals since joining this committee has been to not just help the Postal Service get by, but to help it be strong again and remain viable for the long term.

Despite my efforts, those of my predecessors on this committee, and those of postal management, postal employees, and others, we find ourselves closer than we've ever been to losing the vital services that the Postal Service offers. At risk as well are the approximately 8 million jobs that depend on its continued vitality.

The Postal Service has maxed out its credit line with the Treasury and is rapidly running out of cash. Despite an improving economy and some positive signals from some parts of its business, its immediate future is unfortunately not very bright. Absent legislative intervention, the Postal Service will likely limp along for a few months unable to invest for the future, with its employees and customers uncertain of what that future holds. It can only limp this way for so long.

There is no single easy solution to this problem. It's a problem that has been years in the making, and will take years still to tackle. But, with urgent action from Congress and the administration, the collapse of the Postal Service is avoidable.

Last week, my colleagues and I debated the tough decisions that will need to be made in the coming months and years regarding the level of service the Postal Service should offer the American people. We also discussed how it should price and market its products. Most importantly, we heard about some innovative ways the Postal Service can make itself relevant to new generations of customers by taking creative advantage of its one-of-a-kind retail, processing, and delivery network.

Today, our focus will be the postal workforce and the steps the Postal Service must take to make sure it has the right people with the right skills as it works to survive and thrive in the years to come. We will also touch on the financial obligations the Postal Service - and, by extension, the Treasury - has made to postal employees, and how those obligations should be funded.

At its peak in 1999, the postal workforce totaled about 800,000 people. Today, the Postal Service employs just under 500,000 men and women to service an ever-growing number of addresses across the country. This is possible due in part to the recent declines in mail volume, but also to automation and some hard work on the part of postal management and the rank and file to make processing and delivering the mail more efficient. More clearly must be done in this area. My bill I've introduced with Dr. Coburn would help.

Our bill would also help end longstanding debates about how much the Postal Service owes the Treasury for its employees' pension and health care obligations, how much it should be paying to fund these obligations, and how aggressive its payment schedule should be.

On pensions, we would require the Office of Personnel Management to use more accurate data on how postal employees are paid and how much they actually draw down over their lifetimes from the Federal Employees Retirement System and the Civil Service Retirement System. This reform would likely save the Postal Service billions over time. It would also show that the Postal Service had overpaid its FERS obligations and result in a refund of as much as $6 billion.

On health care, we would end the extremely aggressive schedule put into place in 2006 to pay down the Postal Service's unfunded retiree health obligation.

That payment schedule was put into place for a noble purpose. The goal was to make certain that a then-healthy Postal Service that faced an uncertain future due to the growth in electronic communication was putting away as much money as it could so that taxpayers wouldn't be stuck with its health care bill. But the size of the payments have been crippling.

Our bill would create a more sensible and affordable schedule for paying down the vast majority of the Postal Service's long-term obligation over the next 40 years. It would also give the Postal Service access to the more than $40 billion in its retiree health account today to pay its growing costs related to premiums for current retirees.

These reforms alone would make the Postal Service's books look dramatically better, and free up cash that it can use to invest in innovation, its vehicle fleet, and other long-neglected needs. But the reforms in our bill intended to enable more efficient use of the Medicare benefits the Postal Service and its retirees have paid for have the potential to dramatically reduce its outstanding health care obligations, and as a result its retiree health pre-funding payments.

Finally, our bill would give the Postal Service and the unions representing its employees the authority they need to have a full - and hopefully productive - conversation about the package of pay and benefits current and future postal employees should receive. Unlike other proposals that have been made over the years, it would not enable layoffs or break union contracts. Rather, it would simply require a conversation and trade-offs between management and labor. This reflects the fact that it is not my goal to make postal employees pay the price associated with fixing the Postal Service.

Before I turn to Dr. Coburn for his statement, I'll point out that my goal is - and what I believe what his goal as well. Our goal is to provide some certainty to both postal employees and customers. It's also to ensure that taxpayers — along with all of the fiscal challenges we face as a country — are not also saddled with shoring up a failing Postal Service. I don't want to be back here in a few years discussing how we can dig ourselves out of yet another postal crisis.

UNITED STATES
POSTAL SERVICE

STATEMENT OF
POSTMASTER GENERAL AND CHIEF EXECUTIVE OFFICER
PATRICK R. DONAHOE
BEFORE THE
COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

SEPTEMBER 26, 2013

Good morning, Chairman Carper, Ranking Member Coburn, and members of the Committee. Thank you, Chairman Carper, for your continued leadership on comprehensive postal reform legislation, and for calling this hearing to discuss S. 1486, the *Postal Reform Act of 2013,* and specifically issues related to the postal workforce. Thank you, Ranking Member Coburn, for working in a bipartisan manner as an original cosponsor of the *Postal Reform Act of 2013.* The U.S. Postal Service needs comprehensive legislation that will allow us to achieve $20 billion in savings. During the 112th Congress, the Senate took action to pass bipartisan postal reform legislation in the form of S. 1789, the *21st Century Postal Service Act.* We appreciate that effort, and the effort extended by the Senate to work with the House until the final hours of the 112th Congress to find compromise on a major postal reform bill. However, those efforts ultimately did not lead to enacted legislation. We continue to urge the 113th Congress to act swiftly to pass comprehensive postal reform that will change our business model and combine with management actions to restore the financial viability of the Postal Service.

USPS FINANCIAL CONDITION

The Postal Service continues to be in a very poor financial position as the depth of its $62 billion liability could only be partially filled with $22 billion in assets, as of June 30, 2013. *[Figure 1]* The Postal Service has reached its statutory debt limit of $15 billion and it held unrestricted cash representing only 11 days of average daily operating expenses. Current projections indicate that it will continue to have a dangerously low level of liquidity in the foreseeable future. The Postal Service will be unable to make the required $5.6 billion Retiree Health Benefits (RHB) prefunding payment due by September 30, 2013. This is in addition to similar payment defaults on $11.1 billion in 2012. Our cash position will continue to worsen in October 2013, when the Postal Service is required to make its annual payment of approximately $1.4 billion to the Department of Labor (DOL) for workers' compensation expenses. By mid-October 2013, the Postal Service projects it will have a cash balance on hand of approximately five days of average daily expenses. For an organization the size of the Postal Service – which has revenues of $65 billion and a total workforce of approximately 490,000 career employees – that is a razor thin margin. By way of comparison, most private sector companies usually have available liquidity of at least two months of operating expenses.

UNITED STATES POSTAL SERVICE®
USPS Financial Position as of June 30, 2013

Liabilities Exceed Assets by nearly $40 billion

The USPS has only 37 cents of Assets to cover each dollar of its Liabilities

ASSETS		LIABILITIES	
Cash	$ 3.1B	Retiree Health Benefits	$15.3B
Buildings & Equipment, net of depreciation	$ 17.8B	Workers' Compensation	$16.5B
Other assets	$ 1.6B	Debt	$15.0B
		Accrued Compensation, benefits and leave	$ 4.3B
		Deferred Revenue	$ 4.1B
		Other	$ 6.0B
Total Assets	$22.5B	**Total Liabilities**	**$61.2B**

Figure 1

The Postal Service has seen seven consecutive quarters of net losses and has recorded losses in 16 of the last 18 quarters. For the first nine months of Fiscal Year (FY) 2013, we recorded a net loss of $3.9 billion. Last year, the Postal Service recorded a net loss of $15.9 billion and defaulted on RHB prepayments to the United States Treasury of $11.1 billion. In the past six fiscal years since enactment of Congressionally-mandated prefunding, the Postal Service has incurred $41 billion of net losses, including $32 billion of expenses for prefunding RHB. As of June 30, 2013, we had $22 billion of assets versus $61 billion of liabilities – roughly 37 cents of assets to pay each dollar of liabilities. This financial condition, combined with continuing multi-billion dollar losses highlight the need for immediate legislative reform. To be clear, the Postal Service does not have the authority or the tools to manage these massive obligations without comprehensive postal reform legislation.

The results from the most recent financial quarter show a continuous decline in First-Class Mail, our most profitable category of mail. The loss of First-Class Mail is the primary driver of the decrease in profit margins that the Postal Service has experienced since FY 2007. *[Figure 2]* The most significant factor contributing to the ongoing decline is the migration toward electronic communication and transactional alternatives.

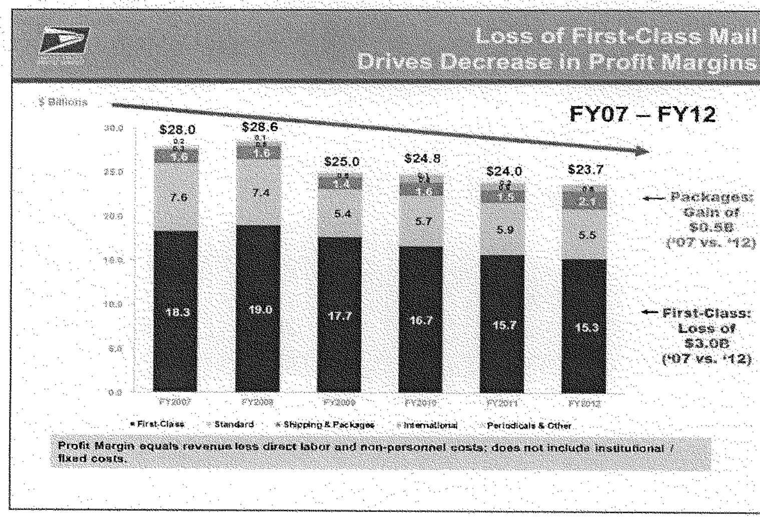


Figure 2

While the shift to electronic communication alternatives has a pronounced negative effect on First-Class Mail volume and revenue, the expansion of e-commerce and successful marketing campaigns has grown our Shipping and Package business. However, the increased revenue in Shipping and Packages does not provide enough contribution to offset the decline of First-Class Mail. Packages are far more expensive to process, transport, and deliver than letter mail. It takes approximately $3 in package revenue to make up for every dollar lost by First-Class Mail. To cover the $6 billion decline in First-Class revenue expected by 2017, package revenue would need to grow by $18 billion, or 55 percent, from its 2012 level.

The Postal Service has laid out a path forward for future growth and stability. On April 17, 2013, the Postal Service released its updated comprehensive 2013 Five-Year Business Plan, which details the implementation of its targeted program to eliminate $20 billion of annual cost from the business by 2017. The plan addresses our unfunded retirement liabilities head on, by proposing meaningful change, such as health benefit reforms that would properly integrate with Medicare either through a USPS-sponsored health plan or a redesign of some existing Federal Employees' Health Benefit Plan (FEHBP) plans. Such a plan would essentially eliminate the unfunded RHB liability primarily by integrating with Medicare, as substantially all private sector firms have done for years. Why debate amortization periods for unfunded balances when we should attack the root problem of high costs? We further address the unfunded retirement liability issue through our proposal to create a defined contribution retirement plan for employees hired in the future, one that creates a more portable retirement plan for them. Now is the time for bold and sweeping action, which will allow us to move forward with solutions that will last for years to come, instead of piecemeal efforts that will only bring us back here again, pursuing legislative reform in a few years. We need to act now to implement strategies designed not only for the Postal Service of today, but for the Postal Service of ten, and even twenty years into the future.

COST CONTAINMENT AND IMPROVED EFFICIENCY

The Postal Service has taken actions to contain costs and improve efficiency to adapt to the country's changing mailing and shipping needs. Operational initiatives have been implemented to better align network size and cost with reduced mail volumes. These initiatives include the accelerated consolidation of mail processing and delivery networks, and the reduction in hours at 13,000 Post Offices, in conjunction with the expansion of alternate retail access. We listened to the American public, and we preserved Post Offices in rural areas throughout the country. The POSt Plan keeps rural Post Offices open by matching retail hours to customer demand. In addition, there are almost 400 Village Post Offices (VPOs) now open as a way to increase access to postal products and services in rural communities. Rationalization of our mail processing facilities allows us to provide an efficient and affordable network and supporting infrastructure that corresponds to reduced mail volume. Savings from these network consolidations are, in almost all cases, more than the Postal Service anticipated, and have been implemented without forced career job losses. These extensive operational changes are being executed even as the Postal Service continues to deliver high levels of service to communities throughout America. This realignment of mail processing, retail, and delivery operations is expected to generate $6 billion in annual cost reductions by the year 2016.

The Postal Service also continues to implement efficiency measures by aligning staffing levels with projected mail volume. These staffing level reductions will be achieved primarily through attrition, as approximately one-half of career employees are eligible for retirement. Approximately 22,800 eligible employees represented by the American Postal Workers' Union (APWU) retired or separated from the Postal Service in the second quarter of fiscal year (FY) 2013, as a result of a special incentive and voluntary early retirement offer. In the fourth quarter of FY 2012, 4,275 eligible postmasters and 2,925 eligible mail handlers retired or separated from the Postal Service. The Postal Service also successfully convinced recent arbitration panels to allow for increased utilization of lower-cost non-career employees in the letter carrier and mail handler crafts, consistent with the contractual agreement with the American Postal Workers' Union (APWU), which will facilitate the realignment of staffing and workload levels and the reduction of costs. The Postal Service's current career workforce of 492,000 is the smallest it has been in decades and is down nearly 26 percent in the past five years.

REVENUE GENERATION

The Postal Service also continues to introduce new service offerings to generate additional revenue and to slow the migration of existing revenue streams to electronic alternatives. Expanded use of digital technologies, using connectivity to various websites, social media, and points of purchase are a focus in enhancing the mail experience. The July 28, 2013 rebranding of Express Mail as Priority Mail Express leverages the strong Priority Mail® brand with a money-back guarantee for next-day service to most U.S. destinations. Changes to the Priority Mail® lineup of products include features such as improved USPS Tracking®, day-specific delivery, and free insurance coverage. However, legislative action is required to give the Postal Service authority to generate new revenue and adapt to changing business conditions, as the scope of products and services that the Postal Service can offer is currently limited by law.

LEGISLATIVE REQUIREMENTS

Repairing the Postal Service's financial condition requires the comprehensive approach reflected in our Five-Year Business Plan, which is available for public viewing on our website. The plan provides a roadmap to restore financial stability and preserve affordable mail service for the American public. The major elements of the Plan must be executed within a short window of opportunity, as the longer the wait, the greater the "crisis of confidence" that will be created with our customers.

The Postal Service needs to save $20 billion annually by 2017. Much of the savings cannot be achieved without legislative action. The legislative requirements put forward by the Postal Service constitute a fair and thorough means to stabilize the Postal Service and create a platform for future growth. The requirements include:

1. Require USPS Health Care Plan (Eliminates RHB Unfunded Liability)
2. Refund FERS Overpayment and Adjust Future FERS Payment Amount
3. Adjust Delivery Frequency (Six-Day Packages/Five-Day Mail)
4. Streamline Governance Model (Eliminate Duplicative Oversight)
5. Provide Authority to Expand Products and Services
6. Require Defined Contribution Retirement System for Future Postal Employees
7. Require Arbitrators to Consider Financial Condition of Postal Service
8. Reform Workers' Compensation
9. Right to Appeal EEOC Class Action Decisions to Federal Court

Each of the Postal Service's legislative requirements is explained in further detail below.

A. FIX THE UNAFFORDABLE BENEFITS SYSTEMS IN A RESPONSIBLE MANNER

Require USPS Health Care Plan:

One of the most important proposals contained in our plan, and one which represents tremendous cost savings, is a change in the way we provide health care to our employees and retirees. More than 20 cents of every revenue dollar the Postal Service takes in is required to go toward health care costs. *[Figure 3]* The cost of this large component of our total operating costs, second only to wages, is largely outside of our control.

To put it simply, the Postal Service would already be nearly fully funded in our retiree health benefits obligations if we could fully integrate with Medicare. Significant health benefits savings are created by integrating the plan for current and future retirees with Medicare in exactly the same way it is predominantly done in the private sector by every responsible employer that offers health care benefits to its retirees, and in state and local government plans. After a retiree reaches age 65, Medicare becomes the primary insurance, and the employer plan is secondary. With Medicare responsible for paying first, the employer sponsored plan becomes much more affordable. With reduced long-term health benefits costs, the RHB liability will be cut nearly in half, eliminating the need for prefunding. However, while the Postal Service has been the second-largest employer contributor of Medicare taxes, we are not getting full value from that program, because a significant proportion of our retirees do not enroll in Medicare when they become eligible.

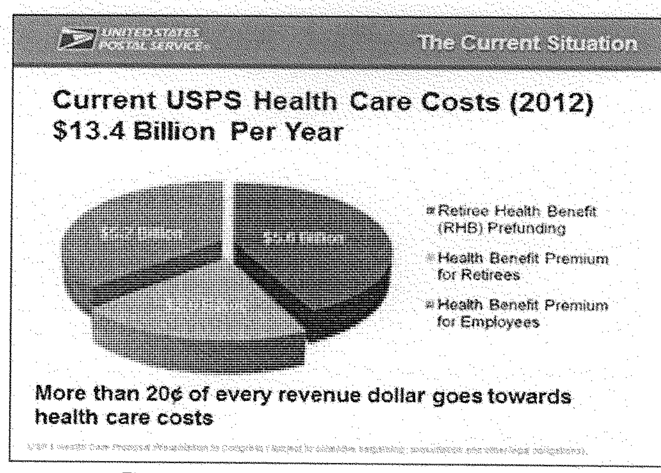


Figure 3

There is a substantial opportunity for savings – approximately $8 billion each year through 2016 – by moving to a more modern, responsive and customer-focused system. This would be accomplished by allowing the Postal Service to sponsor its own healthcare plan, or design plans within the FEHBP. Indeed, the Government Accountability Office (GAO) found in a recent report that the Postal Service would likely realize large financial gains from its proposed health care plan, which would go a long way toward putting the Postal Service on a path to solvency and long-term financial stability. The GAO also estimated that if the proposed health plan had been implemented in 2013, most postal employees and retirees would have had similar or lower premiums compared to the selected FEHB plans, with similar or higher levels of coverage for many services.

A Postal Service-sponsored health care plan that properly integrates with Medicare is critical. Without addressing the cost issue in a responsible way, the Postal Service may be unable to afford to provide health benefits to retirees. Congressional action to allow this fundamental change would dramatically reduce health care spending, and help the Postal Service take a significant step toward financial stability, by taking full advantage of Medicare Parts A, B, and D benefits. The chart below *[Figure 4]* illustrates what the FEHB Plan paid in claims costs in 2011 for annuitants who were older than 65 and had not signed up for Medicare A and B. For a retiree older than age 65, the average claims cost if the retiree had not signed up for Medicare was $10,731. By integrating with Medicare A and B, FEHB claims cost are estimated to be reduced to $4,600. Full Medicare integration (i.e. Medicare A, B, and D) would save an additional $1,200 per Medicare retiree, resulting in an average cost of $3,400. These average claim costs drive the total liability (shown on the right side of *Figure 4*). As you will note, full Medicare integration eliminates the unfunded liability for retiree health benefits.

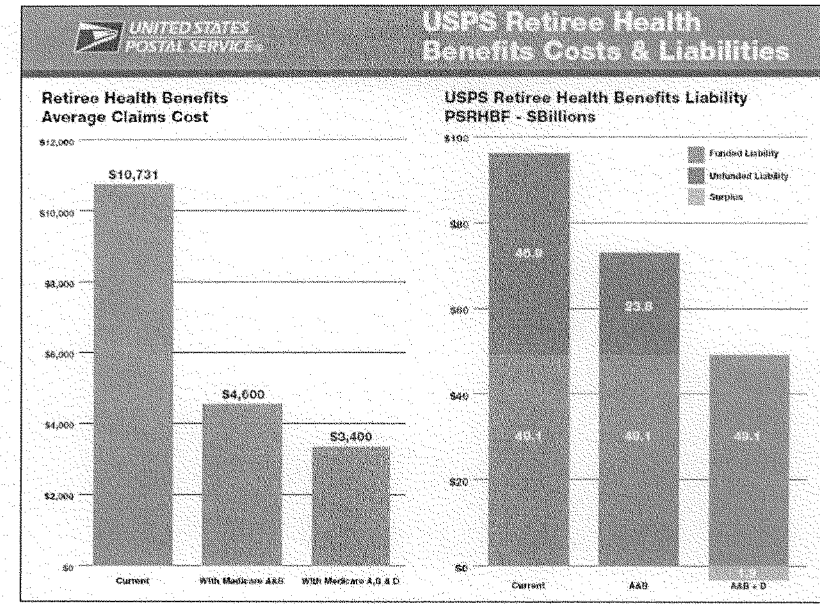


Figure 4

Refund FERS Overpayment:

Postal Service employees participate in one of three Federal government pension programs. These programs are administered by the Office of Personnel Management (OPM). OPM has determined that the Postal Service has overfunded its obligation to the Federal Employees' Retirement System (FERS). According to the most recent actuarial estimate from OPM, the Postal Service has overfunded its FERS obligation by $3.0 billion, as of September 30, 2012. This estimated surplus is less than amounts previously reported, due to changes in the government-wide economic and demographic assumptions made by OPM.

In December 2012, the Postal Service Office of the Inspector General (OIG) issued an update to a previously released paper on the causes of the FERS surplus. The Postal Service agrees with the major conclusions in the OIG's report. First, the distinctive characteristics of the Postal Service workforce, including lower salary increases than the rest of the Federal government, indicate that our FERS surplus is larger than the OPM's current calculation, and OPM should use Postal Service-specific data and assumptions to calculate the surplus. Second, in order to prevent excessive surpluses from accumulating in the future, OPM should adjust the future USPS FERS contribution rate to also take into account Postal

Service-specific data and assumptions. The current FERS charges are too high, as evidenced by 20 years of surpluses, and contribute to the Postal Service's financial crisis. Third, once calculated, the current surplus should be refunded to the Postal Service. The Postal Service, using postal-specific demographics and assumptions, estimates the FERS overfunding amount to be approximately $6 billion. Directing OPM to utilize postal-specific demographics and assumptions in calculating the correct amount of the FERS surplus and returning the full amount of that surplus to the Postal Service is important, and needs to be completed this year. The Administration agrees with this approach, as evidenced in its 2014 budget request, which requires OPM to calculate FERS costs using actuarial assumptions and demographics specific to the Postal Service workforce. We appreciate that S. 1486 requires OPM to use postal-specific demographics and salary growth assumptions in calculating both the surplus and the Postal Service's ongoing contribution rate, and that it also returns the resulting surplus to the Postal Service.

Require Defined Contribution Retirement System for Future Postal Employees:

The Postal Service's current employees participate in one of three federal government pension programs, all of which include defined benefit plans. But the Postal Service is changing. Employees coming in now will likely have different careers than current employees. We should provide a retirement system that benefits both the employee of the future and the Postal Service. The Postal Service proposes this new retirement system, for future employees only, for five main reasons:

1. The ability to meet obligations under the Postal Reorganization Act (PRA).
   The Postal Service is required to provide wages and benefits comparable to those provided in the entire private sector. The FERS system is not comparable to pension programs in the entire private sector and is more costly. Permitting this move would allow the Postal Service, like the private sector, to adjust to market conditions by modifying plan design, portability, provider services, employee engagement and other factors.
2. The Postal Service's employee base is changing.
   Our emerging workforce is younger and less likely to stay with one employer for their entire career, as most of our established employees have done. This type of portable and flexible retirement program holds a greater appeal for the younger demographic.
3. Permits a reduction in labor costs.
   The Postal Service is a labor intensive organization, with labor costs making up the majority of its total costs. Benefit costs constitute approximately half of total labor costs when RHB prefunding is included. Even if the RHB prefunding requirement were removed, benefit costs would still make up a substantial portion of the Postal Service's labor costs. We cannot resolve our fiscal problems without addressing this issue.

4. Separates Postal Service retirement system from the rest of the Federal Government.
   There continue to be ongoing debates regarding Postal Service funding of both the Civil Service Retirement System (CSRS) and FERS retirement systems. These tensions will continue, given that the Postal Service has funded substantially more of its pension obligations than the remainder of the Federal government. Allowing the separation of the Postal Service's retirement obligations would ensure that these disputes do not arise with respect to future employees.
5. Protects the American taxpayer.
   A defined contribution retirement system for future employees would help ensure that the Postal Service remains financially viable, and can therefore fulfill its obligations not only to future employees, but to retirees and current employees as well. This, in turn, provides an added level of protection for taxpayers, as it significantly lessens the possibility that taxes would have to be used to fund these payments.

It should be noted that this change would not impact the existing retirement systems for current employees. The new system would be implemented for newly hired employees in the future.

B. ELIMINATE DUPLICATIVE OVERSIGHT AND UNNECESSARY BUREACRACY

Streamline Governance Model:
In order to meet the challenges it faces both today and in the future, the Postal Service must be given the tools to become a more nimble, streamlined organization, better able to respond quickly to the needs of a dynamic marketplace and to adjust our operations as demand for products and services evolves. The Postal Service does not need additional bureaucracy to slow us down. We urgently need the flexibility to implement our Five-Year Business Plan.

The Postal Service Board of Governors should have the clear authority to make structural changes that reduce the costs of the retail, processing and delivery networks. Currently, the Governors must submit operational changes to the Postal Regulatory Commission (PRC) for advisory opinions which are then coupled with lengthy, litigious, administrative proceedings that do not promote timely and effective implementation of necessary, efficient cost reduction decisions. The current process imposes substantial costs on the Postal Service, delays the realization of cost savings and should be eliminated. S. 1486 replaces the current process with one where the Board conducts formal outreach to customers prior to implementing significant service changes, a change to the law that we strongly support. At an absolute minimum, the law should require that the PRC use substantially streamlined procedures to produce timely opinions.

Another facet of restoring financial sustainability is the growth of revenue through product and pricing innovation, both with respect to existing lines of business and new lines of business. Giving the Board greater authority to exercise business judgment in this area does not mean the end of oversight by an external entity. Rather, a more nimble and well-defined regulatory approach is required to minimize unnecessary bureaucracy, and recognize that the Postal Service faces intense competition with respect to all of its products, including those subject to the statutory monopoly. Such an approach will allow the Board to respond more effectively to changing conditions. Even the PRC has recognized, in its *Annual Report to the President and Congress*, that the current system of regulation is not achieving the objective of financial stability.

Giving the Postal Service greater flexibility over pricing and product innovation would further advance the goal of providing universal service in a financially sustainable manner. The Postal Service faces intense competitive pressures, and has strong commercial incentives to be efficient and responsive to its customers' needs. Extensive price and product controls are therefore not necessary to protect customers, as has been recognized in other countries that have streamlined their regulation of the post in recent years, including countries that, like the United States, continue to have a government post whose provision of universal service is supported by a monopoly. Governors' decisions on new products and pricing should be subject to after-the-fact reviews (like the current Annual Compliance Determination) or handled through the complaint process. S. 1486 has language that would implement such a system with respect to market-dominant products, which we strongly support.

Pairing much greater flexibility over pricing and product innovation with additional flexibility to address network costs would put the Board in a position to create a multi-faceted and balanced approach to restoring financial stability. The Postal Service's white paper, detailing these streamlined governance proposals is submitted, along with this testimony, for the record.

Adjust Delivery Frequency (six-day package/five-day mail):

In February 2013, the Postal Service put forward a proposal to move to a six-day package/five-day mail delivery schedule. Savings projected from this move (net of the cost of Saturday package delivery, primarily by non-career carriers) are estimated to be approximately $2 billion annually when fully implemented. The proposal provides mail delivery to street addresses Monday through Friday. Mail addressed to P.O. Boxes would continue to be delivered on Saturdays. Post Offices already open on Saturdays would not be affected by this proposal. Packages would continue to be delivered six days per week, and our Priority Mail Express offering, currently delivered seven days per week, would not be impacted. The proposal was designed to serve a dual purpose: first, to respond effectively to the increase in package growth, a 14 percent volume increase over the last two years, secondly, and to address the realities of the public's changing mailing habits. By continuing to deliver Priority Mail

Express, Priority Mail, and most other packages on Saturday, the modified plan responds to many of the concerns expressed by the PRC and others about the impact of five-day delivery on certain customer segments, such as recipients of medicine.

We believe the timing is right to implement this change, especially in light of overwhelming continued support for five-day mail delivery by a vast majority (over 80 percent) of the public. Additionally, in his FY 2014 budget proposal, released on April 10, the President again included a provision to allow the Postal Service to move to a five-day mail delivery schedule. We appreciate that S. 1486 would allow the Postal Service to move to a five-day schedule, though we request that the one-year delay required in the bill be shortened or eliminated.

Authority to Expand Products and Services:

The Postal Service must be allowed authority to establish new revenue sources and respond to a changing marketplace. Provisions contained in the Senate bill will be helpful in providing flexibility to the Postal Service to offer products and services that would improve our net financial position. S. 1486, grants the authority to introduce new non-postal services and governmental services, and permits the Postal Service to ship beer, wine, and distilled spirits. Such changes are vital to our ability to grow additional revenue and leverage our strengths.

The Postal Service is fully engaged in exploring all options available to us under our existing legal authority. For example, we are currently focused on ensuring our presence in the digital world, through the work done by our Secure Digital Solutions group. Potential product offerings and services include identity and access management services and secure messaging. The Postal Service is confident that it can leverage critical brand components, such as trust, convenience, security and privacy. The Postal Inspection Service, the law enforcement arm of the Postal Service, plays an important part in our efforts to move into the digital realm. The Postal Service has been named the Most Trusted Government Agency for seven years and the fifth Most Trusted Business in the nation by the Ponemon Institute. We value that trust and we intend to build upon it, in both the physical mail and the digital mail worlds. Our return to financial viability is dependent on finding innovative ways to use the mail. A critical part of that is obtaining legislative change that will enable the Postal Service to offer additional products and services and improve our financial condition.

C. CHANGES NECESSARY TO PUT THE POSTAL SERVICE ON A LEVEL PLAYING FIELD

Require Arbitrators to Consider the Financial Condition of the Postal Service:

More than 85 percent of the Postal Service's career employees are covered by collective bargaining agreements. By law, when the parties are unable to conclude an agreement through negotiations, they must resort to final and binding interest arbitration, meaning that at impartial third party writes their contract. This process is of crucial importance to the Postal Service, as approximately 80 percent of its expenses are labor costs.

Interest arbitrators should be required, by law, to take into account the Postal Service's financial condition when issuing an award of a multi-year collective bargaining agreement worth tens of billions of dollars to the parties. While some interest arbitrators do consider the Postal Service's financial condition, there is no legal requirement that they do so. The past several years have focused the attention of the Postal Service and the Congress on the Postal Service's financial situation; interest arbitrators should be directed to apply the same focus. S. 1486 would require arbitrators to consider the financial condition of the Postal Service when rendering decisions, which the Postal Service supports.

Reform Workers' Compensation:

Postal employees injured on the job are covered by the Federal Employees' Compensation Act (FECA), administered by the Department of Labor's (DOL's) Office of Workers' Compensation Programs (OWCP), which makes all decisions regarding injured workers' eligibility for benefits. The Senate bill, S. 1486, would substantially reform the workers' compensation process for the entire federal government, and we applaud the Senate's efforts in this vein. Specifically, similar to many state systems, the Senate bill would require employees who receive long-term workers' compensation benefits to retire upon becoming eligible to do so. While we endorse this change, there is another modification of the current system that is necessary: allow the Postal Service to settle workers' compensation claims. While many state systems allow employers to settle these claims, current federal law does not. Allowing the Postal Service to settle workers' compensation claims would be fair to the employees and beneficial for the Postal Service.

Right to Appeal EEOC Class Action Decisions to Federal Court:

The Equal Employment Opportunity Commission (EEOC) currently possesses largely unreviewable authority in applying employment discrimination statutes to federal employers. While individual employees and applicants for employment may file actions in the federal courts when they are dissatisfied with the Commission's decisions, federal employers do not have that right. Class actions certified by the EEOC are a particular problem for the Postal Service, given the size of these cases. For example, the Postal Service is currently litigating a class action before the EEOC with more than 130,000 putative class members. The EEOC does not apply the same class certification rules that the federal courts do, meaning that large and unmanageable cases are often certified as class actions under circumstances that would not pass muster in federal courts. Even class actions with no merit can cost millions of dollars to defend. Under current law, if a class is certified improperly, the Postal Service cannot initiate a challenge to the certification decision in federal court. We propose that this be changed, and that the Postal Service be allowed to seek judicial review of EEOC decisions certifying class actions.

POSTAL SERVICE ACTIONS

The Postal Service's updated Five-Year Business Plan eliminates nearly $20 billion of annual cost from the business by the year 2017. *[Figure 5]* By carefully managing what is within its control, the Postal Service is currently running ahead of plan in FY 2013.

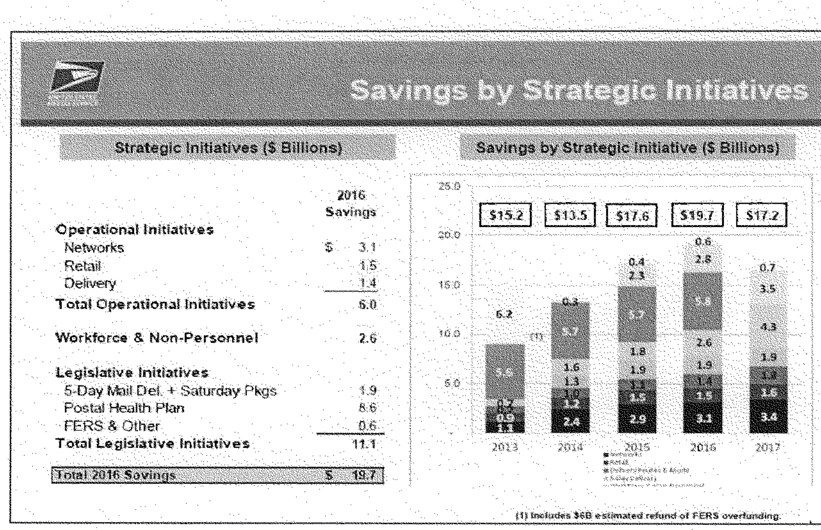


Figure 5

The actions of the Postal Service alone are not enough to return us to profitability, and we continue to pursue all avenues for change. The Plan requires a combination of operational realignment, aggressive cost reductions, and comprehensive legislation, as described earlier, to reform the Postal Service's current business model. Several key provisions include better alignment of network size and cost with reduced mail volumes, revenue management and increased growth, the implementation of a USPS sponsored healthcare plan for active and retired employees, and business model changes, including implementation of a new delivery schedule.

CONCLUSION

The Postal Service continues to make great strides in adapting to the country's changing mailing and shipping needs. However, our efforts are severely limited by a statutorily-mandated, restrictive business model, and by excessive, bureaucratic oversight that prevents the Board and postal management from effectively running the business. We have the responsibility to provide and to fund universal service for our nation, but we do not have sufficient authority or flexibility to efficiently carry out that mandate. Postal reform legislation is urgently needed. In its absence, continued significant net losses are inevitable. If provided the ability to make needed changes, the Postal Service has a bright future. We could again be a model of self-sufficiency. I look forward to the swift passage of legislation and the end to Congressional hearings discussing the Postal Service's financial losses. Then, we can finally shift our full attention back to what is really important to the men and women of the United States Postal Service - delivering for the American people.

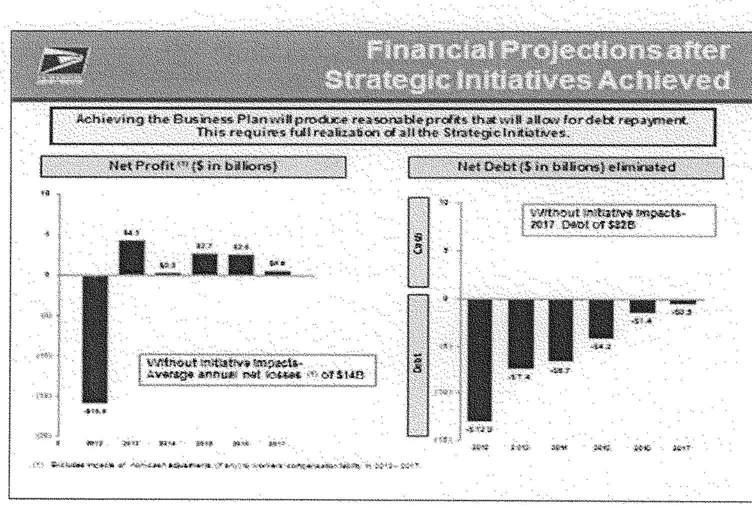


Figure 6

Simply put, the enactment of comprehensive postal reform legislation cannot wait. The Postal Service has exhausted its borrowing authority, faces massive unnecessary unfunded liabilities, and is constrained in how far it can go to bridge the massive gap between revenues and expenses. In no uncertain terms, the Postal Service does not want to become a burden on the American taxpayer. The successful implementation of strategic initiatives included in our Five-Year Business Plan would bring tremendous results, allowing for increased net profits and elimination of existing debt. *[Figure 6]* We cannot get there by our actions alone, however. There exists no scenario where the Postal Service returns to financial stability without enactment of postal reform legislation. Comprehensive and wide-ranging postal reform legislation, as opposed to narrow piecemeal efforts, is desperately needed. We must avoid a situation where the Postal Service's financial crisis causes mailers to seek out alternatives. Mr. Chairman, we look forward to continuing to work with you and the rest of the Committee to accomplish meaningful postal reform legislation.

February 11, 2013
United States Postal Service

POSTAL SERVICE GOVERNANCE

The Need for Fundamental Reform

The Postal Service faces both a short-term liquidity crisis, and a longer-term challenge of accommodating fundamental changes in the demand for its services. Mail has, and will continue to have, great value as a means of communication, advertising, and fulfillment, and the Postal Service remains a vital part of the United States economy and the key to providing universal mail service for our country. Nevertheless, certain mail volumes declined have substantially due to the recent recession and the diversion of mail to alternate means of communication (a trend itself accelerated by the economic downturn). Going forward, total mail volumes will likely continue to decline, before possibly plateauing, as society increasingly utilizes electronic alternatives to First-Class Mail. Given its current business model, the Postal Service's ability to finance universal service for the American people is therefore increasingly challenged.

There is potential for revenue growth in Standard Mail (direct mail) and especially in packages, as well as through targeted digital offerings, and the Postal Service is continually striving to improve the relevance of its products and services to ensure such growth. Furthermore, even though First-Class Mail volumes will likely decline, demand for First-Class Mail will continue to be very robust in absolute terms well into the foreseeable future. These factors demonstrate the continued demand for the mail, and the continued importance of universal mail service to American society and commerce. However, it is also clear that the Postal Service's *current* business model is not sustainable in light of existing volume levels, and expected volume trends. This fact necessitates fundamental reforms so that the Postal Service can become financially viable and continue to finance essential services to the Nation that are needed now and for the foreseeable future.

In order to meet its challenges, the Postal Service must be given the tools to be a more nimble, streamlined, business-like organization, better able to respond quickly to the needs of a dynamic marketplace and to adjust its operations as demand for its services evolve While this was a broad goal of the Postal Accountability and Enhancement Act of 2006 (PAEA), the incremental reforms actually put into place by that law have not created a foundation by which universal service can be provided in a financially sustainable manner. Indeed, while the PAEA afforded some additional flexibility, overall it did not give the Board of Governors (Board) the ability to take the actions needed to respond to the rapidly changing business environment. Given the financial challenges facing the Postal Service, further postal reform legislation is urgently needed.

However, a postal reform package that makes only incremental changes to current law would merely be a temporary salve for the Postal Service. The Board strongly believes that it is not in the interests of Congress, the Postal Service, or the American people for postal reform to be a recurring legislative issue, in which Congress must on a periodic basis act to give the Board limited additional authority to shore up the Postal Service's finances. Under such a scenario, the Postal Service would be continually in a state of ongoing or impending crisis regarding its financial stability, which would only make it more difficult to succeed in the highly competitive messaging and package marketplaces. Indeed, the current financial uncertainty causes industry to hesitate in investing in the future of the mail, hampering efforts to grow revenue, and jeopardizing the provision of prompt, reliable, and efficient mail and package delivery services. Congress should therefore enact legislation that gives the Board the tools to proactively address the Postal Service's challenges, in order to maximize the prospects that financial stability can not only be temporarily restored, but can be *maintained* over a meaningful period of time in an environment characterized by intense competition and changing societal mores regarding use of the mail,.

Fundamental Reform Requires Giving the Board the Clear Authority to Implement Necessary Decisions

In order to ensure that the Postal Service can both restore its short-term financial stability, and have the prospect of maintaining that stability going forward, the Board must be given the ability to reduce costs and grow revenue with much greater speed and flexibility than is possible under current law. In short, in order to preserve the central goal of postal policy—the provision of prompt, reliable, and affordable universal service to the American people in a financially self-sustainable manner—the Board must have greater authority to respond to the changing marketplace through the exercise of its business judgment, without being handicapped by overly restrictive statutory provisions, and excessive bureaucracy. Achieving this result requires a fundamental change to the system of governance under which the Postal Service operates. While the Board has the responsibility under the law to provide universal service in a financially self-sufficient manner, it lacks the authority to effectuate that responsibility. It should be given authority commensurate with its responsibility.

The need for postal services to be provided on a more commercial basis, and the better matching of authority with responsibility, were original factors behind the establishment of the Postal Service. A principal finding of the Kappel Commission Report of 1968, which discussed the ailing Post Office Department, was what it characterized as the phenomenon of "no control" on the part of the leaders of the Department over critical postal issues. Meaningful postal reform, the Commission found, necessitated a fundamental change in the relationship between the Department and Congress, with the latter relinquishing much of the control it exercised over postal matters, and instead placing full responsibility—and authority matched to that responsibility—in the hands of a board of directors, responsible for providing universal postal services in a self-sufficient, business-like manner.

The Postal Reorganization Act of 1970 (PRA), which created the Postal Service, addressed many of the deficiencies identified by the Kappel Commission, but also limited the Board's ability to exercise control over finances. In terms of revenues, the design of prices was placed in the hands of the independent Postal Rate Commission, composed of Commissioners who, like the Governors, are appointed by the President and confirmed by the Senate, and who serve the public interest. Pricing and product innovation also required adherence to cumbersome administrative procedures that could take nearly a year to complete. Significantly, however, the Governors retained the ability to modify the prices recommended by the Commission in order to ensure sufficient overall revenues. On the other hand, a significant portion of labor costs was still dictated by Congress, because of the continued participation of employees in Federal pension, health, and workers' compensation programs, which remains the case today. The ability to make changes to network costs was also limited by the PRA, in the form of a cumbersome advisory opinion process for significant service changes, and also by subsequent Congressional enactments (which, among other things, annually mandated the continuation of 6-day delivery).

The PAEA re-structured control over one area of postal law, regarding products and pricing, based on a belief that the PRA did not give the Postal Service the ability to quickly respond to the market, or sufficient incentives for efficiency. While the law provided some additional flexibility, it took away the Governors' authority to ensure that prices generated sufficient revenues to cover costs, through the imposition of a price cap on the Postal Service's "market dominant" products, which generate the substantial majority of Postal Service revenues. This cap was predicated on a measure of household inflation, the Consumer Price Index (CPI), rather than reflecting the Postal Service's particular cost inputs.

In exchange for the constraints imposed by the cap, the Postal Service was given the ability to assert more control over product innovation and price design, at least with respect to its "competitive" products. On the "market-dominant" side, the flexibility conferred has been significantly subverted by the Postal Regulatory Commission's (PRC's) imposition of numerous substantive rigidities on pricing, even for those prices that adhere to the cap. Furthermore, while the pricing and product innovation process was streamlined to a certain extent as compared to the PRA system, the PRC still insists on the prior review on all price and product changes, which imposes costs on the Postal Service to prepare extensive filings and delays the generation of needed revenues. In particular, the prior review period for product innovation is not subject to time limitations, and this review has in some instances been very lengthy. The PRC has also set forth an excessively bureaucratic process for approving contracts on the competitive side, which has hindered the Postal Service's ability to attract customers.

While imposing a price cap that limited the Board's control over revenues, the PAEA gave the Board no additional control over its costs (and in fact imposed a new cost in the form of the accelerated prefunding of retiree health benefits). The law also limited the Postal Service's ability to enter new lines of business. Finally, the flexibility in the PAEA did not go far enough: processes required by the law or established by the PRC do not give the Governors sufficient flexibility to address business issues with the speed and flexibility needed in today's marketplace. For instance, the PAEA did not address the lengthy, litigious, and bureaucratic process used by the PRC to issue advisory opinions on significant service changes.

The system put in place by the PAEA demonstrates the dangers of piecemeal, incremental reforms in the current environment facing the Postal Service. In the face of the recent volume declines, the limited tools available to the Postal Service were not sufficient to maintain financial solvency, even with the significant amount of cost-cutting that has been achieved. While conferring flexibility regarding product innovation and price design is important, such tools alone cannot counteract macroeconomic factors and broad societal trends when it comes to demand for the mail. Going forward, the pace of change in the demand for postal services, and the impact of that changing demand on postal finances, will continue to be highly volatile, due to these trends and to the intense competitive pressures facing the Postal Service (which exists for all of its products, including those categorized as "market-dominant"). It is thus critical that the Board have the flexibility to respond quickly and effectively to both the current dire circumstances, as well as future circumstances. To do so, the Board must have the discretion to adopt a *comprehensive*, balanced, and multi-faceted strategy that looks not only at product innovation for existing lines of business, but also at further cost reductions that are not available under current law, at the overall level of revenues generated through pricing, and at new lines of business that are currently foreclosed to the Postal Service. The Board must also have the flexibility to continually reexamine its approach, and adopt new strategies, as circumstances warrant.

The shortcomings of the PAEA also demonstrate the central importance of pairing authority with responsibility. While the Board has set forth a strategy to comprehensively address the Postal Service's financial problems, it lacks the ability to implement that strategy because of restrictions in the law. In addition, other stakeholders with responsibility under the PAEA have taken the position that they did not have the authority to act. In particular, while the PRC was given the responsibility under the PAEA for price regulation, it previously expressed the opinion that addressing the Postal Service's financial challenges rested solely with Congress under the law. In order to provide reform that has the prospect of meaningful staying power, Congress must clearly match authority with responsibility. When that is done, Congress can demand accountability for results.

Opportunities to Increase the Postal Service's Commercial Flexibility

Today, the long-standing issue of the Board having insufficient authority to implement decisions in an efficient and effective manner is of vital importance. In an era of rising volumes, Congress could allow this issue to persist, but it cannot any longer. Difficult decisions need to be made to ensure that the Postal Service can continue to provide universal service for the Nation, without becoming a burden on the American taxpayer. The Board is in the best position to make those decisions. The Governors are appointed by the President, confirmed by the Senate, and required to represent the "public interest generally," and the Board is tasked by law with ensuring that the Postal Service fulfills its statutory duties. Congress should therefore give the Board authority commensurate with its responsibility, and eliminate unnecessary and costly bureaucratic hindrances to the Board exercising that authority. The President and the Senate should also continually strive to ensure that the members of the Board have the requisite and balanced qualifications to oversee an entity of the Postal Service's size.

Enhanced flexibility falls in two basic categories: cost reduction and revenue generation. The Board's overall approach to restoring financial stability has as its central elements the reduction of labor and network costs, and the increase of revenue through enhanced authority to offer products and services and targeted price changes.

In terms of labor costs, benefits liabilities are the most critical issue. While the manner of prefunding is important, a truly sustainable approach must lead to a reduction in the overall magnitude of those liabilities. As such, the Board should be able to move forward with creating improved health care, pension, and workers' compensation programs for the Postal Service that moderate those legacy costs through the leveraging of private sector best practices. A major element of the Board's plan is the creation of a Postal Service health plan. Another approach is to predicate Postal Service benefits costs, such as those for pensions, on a defined dollar amount.

In terms of network costs, the Board should have the clear authority to make structural changes that reduce the costs of the retail, processing, and delivery networks. The Board considers that the submission of each major operational decision to the PRC for an advisory opinion following a litigious, lengthy administrative proceeding does not promote timely and effective implementation of necessary, efficient cost-reduction decisions: the current process imposes substantial litigation costs on the Postal Service, requires the Postal Service to devote staff and resources to litigating the case that could be deployed elsewhere, and delays cost savings. The Postal Service should not have to secure an advisory opinion from the PRC for service changes. At a minimum, PRC procedures should be substantially streamlined and should be after-the-fact or through a complaint process.

Another facet of restoring financial sustainability is the growth of revenue through product innovation and prices, both with respect to existing lines of business and other lines of business. Giving the Board greater authority to exercise its business judgment in this area does not mean the end of oversight from an external entity. But, a more nimble and well-defined regulatory approach is required that minimizes unnecessary bureaucracy, recognizes that the Postal Service faces intense competition with respect to all of its products, and allows the Board to respond effectively to changing conditions. Indeed, even the PRC recently recognized in its Annual Report that the current system of regulation is not achieving the objective of financial stability.

Giving the Postal Service greater flexibility over pricing and product innovation would further advance the goal of providing universal service in a financially sustainable way. This is demonstrated by experience in other countries in which postal operators have been given such flexibility. The Postal Service, like other postal operators, is in the best position to determine the strategies necessary to ensure financial sustainability. In addition, the Postal Service faces the same competitive pressures as other postal operators, and has strong commercial incentives to be efficient and responsive to its customers' needs in order to ensure that its products are competitive. Extensive price and product controls are therefore not necessary. Pairing much greater flexibility over pricing and product innovation with additional flexibility to address network and labor costs would put the Board in a position to craft a multi-faceted and balanced approach to restoring financial sustainability that appropriately considers the circumstances of the Postal Service and its employees, and the needs of its customers.

The Postal Service provides a valued service, and has a bright future so long as necessary changes are made by Congress to its business model. These changes must give the Board the flexibility to comprehensively and proactively meet both the challenges that the Postal Service faces today, and future challenges that may arise. This will enable the Board to fulfill its responsibility of ensuring that the Postal Service continues to provide prompt, reliable, efficient, and sustainable universal service to the American people.

UNITED STATES OFFICE OF PERSONNEL MANAGEMENT

STATEMENT OF
JONATHAN FOLEY
DIRECTOR, PLANNING AND POLICY ANALYSIS
U.S. OFFICE OF PERSONNEL MANAGEMENT

before the

COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

on

"OUTSIDE THE BOX: REFORMING AND RENEWING THE POSTAL SERVICE, PART II – PROMOTING A 21ST CENTURY WORKFORCE"

September 26, 2013

Chairman Carper, Ranking Member Coburn, and Members of the Committee:

Thank you for the opportunity to testify regarding reform of the United States Postal Service (Postal Service or USPS), including changes to employee benefits. The Office of Personnel Management (OPM) recognizes how important it is to the Nation's commerce to have a healthy Postal Service and understands the need to provide financial relief and to undertake reform. However, any reforms should undergo a careful analysis to prevent unintended consequences to Government benefits programs. As program administrator for the Federal Employees Health Benefits (FEHB) Program, Civil Service Retirement System (CSRS), the Federal Employees Retirement System (FERS), and fiduciary for the Civil Service Retirement and Disability Fund (CSRDF) and the Federal Employees Health Benefits Trust Funds, OPM has an interest in the various proposals to reform the benefits available to the Postal Service workforce and their impact on these programs.

Current Postal Service Health and Retirement Benefits Obligations

Under current law, the Postal Service has an obligation to make certain payments related to health and retirement benefits for its employees and retirees. The Postal Accountability and Enhancement Act of 2006 required the Postal Service to pre-fund retiree health benefits and make fixed payments from 2007 through 2016 into the Postal Service Retiree Health Benefit (PSRHB) Fund. The purpose of the PSRHB Fund is to cover the Postal Service's liability for the health care costs of current and future retirees under the FEHB Program. This pre-funding mechanism is unique to the Postal Service. Due to its financial difficulties, the Postal Service was unable to make these required payments of $5.5 billion initially due in FY2011 and $5.6

billion due in FY2012. OPM calculates that the actuarial liability for the PSRHB Fund value was $94 billion as of September 30, 2012. Subtracting the PSRHB Fund value of $46 billion, there remains an unfunded liability of about $48 billion.

With respect to retirement benefits, Postal Service contributions to FERS total approximately $3 billion per year. These expenses are incurred only on behalf of those employees enrolled in FERS. In 2006, Congress discontinued Postal Service contributions on behalf of employees enrolled in CSRS. The FERS funding and employee cost sharing requirements are the same as those that apply to all non-Postal agencies and employees.

The President's FY2014 Budget includes short-term relief and long-term reforms to the Postal Service, including a proposal allowing OPM to calculate the Postal Service share of its FERS costs using Postal-specific demographic assumptions. Pursuant to the proposal, the amount of any Postal FERS actuarial funding surplus as most recently computed according to government-wide actuarial assumptions would be refunded to the Postal Service in 2013, and any remaining amounts would be refunded in 2014 and 2015 after OPM has completed a demographic study of Postal Service data to determine a Postal-specific normal cost percentage. This and other reforms included in the Budget will help the Postal Service return to financial sustainability.

Retirement and Health Benefits in the Postal Reform Act of 2013

I would like to briefly discuss a couple of provisions included in S. 1486, the Postal Reform Act of 2013, regarding Postal Service employee retirement and health benefits. Among other things, the legislation authorizes the Postal Service to negotiate retirement benefit terms for new employees and to create new health benefits plans which may be offered within the FEHB Program.

Negotiability of USPS Retirement Benefits

Postal employees are currently subject to the same rules as Federal employees for the purposes of benefits, employment rights, and other obligations. Section 102 of the legislation would grant labor organizations and the Postal Service the authority to negotiate retirement benefits for employees. OPM is concerned that the ability to negotiate retirement benefits, especially whether an employee is covered in FERS, will result in disparate execution of benefits. That is, employees performing the same work will receive different benefits based on their collective bargaining agreements. Tracking and reporting variable employee deduction rates based on bargaining unit and time period would be nearly impossible and administratively costly, both for OPM and the Postal Service. Retirement claims processing for all agencies would be negatively impacted by the burden of computing such unique Postal Services cases.

Additionally, OPM has technical concerns with section 102(a)(1). Employee retirement contributions to the CSRDF under negotiated agreements require clarification, and OPM would like to work with the Committee to address any technical concerns.

USPS Withdrawal from FEHB Plans

Statement of Jonathan Foley
U.S. Office of Personnel Management

September 26, 2013

Section 104 would authorize the Postal Service to enter into individual or joint collective bargaining agreement or agreements with bargaining representatives to create a single Postal Service Health Benefits Plan (PSHBP). Coverage must be actuarially equivalent to the types of plans available in the FEHB Program.

OPM has long believed and has previously testified before this Committee that the Postal Service and its employees and retirees are well-served by the FEHB Program. Currently, OPM overhead costs for the FEHB Program are only 0.08 percent of total health premiums. These very low overhead costs have been achieved by managing programs with very large numbers of enrollees and the accumulated experience of the agency and its staff having managed these programs for decades. The FEHB Program offers good value to employees and the taxpayer and is not an excessively costly benefit as compared with other large employer plans. In addition, annual premium increases for FEHB plans are typically at or below industry averages.

A Postal withdrawal under Section 104 would have an impact on health plans with a large Postal population, such as Rural Letter Carriers, National Association of Letter Carriers, and the American Postal Workers Union. While Postal employees and retirees represent less than one quarter of the FEHB covered population, 23 health plans are comprised of 50 percent or more Postal employees and retirees and 57 plans are comprised of one third or more Postal employees and retirees. If these plans were to choose to withdraw from the FEHB Program, their remaining members would need to choose another health insurer. This might also reduce choices among plans, which reduces competition.

Section 105 would remove Postal Actives and Postal Annuitants with both parts A and B of Medicare from the FEHB Program risk pool, and create separate FEHBP enrollment options for health benefit plans with a separate risk pool for these individuals and their families. Postal Annuitants without Medicare coverage, with Medicare Part A only, or Medicare Part B only, would be the only Postal groups to remain in the original FEHB Program risk pool. Because the groups to be removed are less expensive than those that are to remain, we anticipate this change will result in an increased cost to the FEHB Program for the original FEHB Program risk pool on a per enrollee basis. If postal employees and retirees are removed from the FEHB Program risk pool under both Sections 104 and 105, costs under the original FEHB Program risk pool would increase by about two percent per enrollee.

Also, it may be challenging for the PSHBP to have provider networks for employees and retirees located all across the country, especially in rural areas. As stated previously, OPM has developed the systems to provide these numerous, locally-based options at very little administrative cost.

Postal Workforce Restructuring

As the Postal Service realigns its operations to reduce its costs, it has and is expected to continue to make use of available authorities to provide early retirement and voluntary separation incentives to its eligible employees. I would like to take the opportunity to highlight the positive impact resulting from Congress' action to authorize the CSRDF's receipt for claims processing costs from agencies offering either voluntary separation incentives or voluntary early out retirements, aiding OPM in its significant reduction of backlogged retirement cases.

Conclusion

Any effort to return the Postal Service to financial sustainability would require careful analysis in order to avoid unintended consequences that could ripple throughout the Government wide retirement and health benefit programs. We look forward to working with the Committee to assist the Postal Service in addressing its fiscal challenges.

United States Government Accountability Office

GAO

Testimony
Before the Committee on Homeland Security and Governmental Affairs, U.S. Senate

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U.S. POSTAL SERVICE

Health and Pension Benefits Proposals Involve Trade-offs

Statement of Frank Todisco, Chief Actuary
Applied Research and Methods

John E. Dicken, Director
Health Care

GAO-13-872T

GAO Highlights

Highlights of GAO-13-872T, a testimony before the Committee on Homeland Security and Governmental Affairs, U.S. Senate

Why GAO Did This Study

USPS continues to be in a serious financial crisis, with little liquidity in the short term and a challenging financial outlook in the long term as profitable First-Class Mail volume continues to decline. Critical decisions by Congress are needed on postal reform legislation that has been proposed in both the U.S. Senate and the House of Representatives. Various proposals would restructure the financing of postal retiree health benefits, including required payments to prefund these benefits; enable USPS to introduce a new health plan for postal employees and retirees; and restructure the funding of postal pensions, including addressing a potential surplus in funding postal pensions under FERS.

GAO has previously testified that a comprehensive package of legislative actions is needed so that USPS can achieve financial viability and assure adequate benefits funding for more than 1 million postal employees and retirees. GAO has also previously reported on various approaches Congress could consider to restructure the funding of USPS retiree health benefits and pensions.

This testimony discusses (1) funding USPS retiree health benefits; (2) USPS's proposal to withdraw its employees and retirees from FEHBP and establish its own health plan; and (3) a potential surplus in funding postal pensions under FERS. This testimony is based primarily on GAO's past work.

View GAO-13-872T. For more information, contact Frank Todisco at (202) 512-2834 or todiscof@gao.gov or John E. Dicken at (202) 512-7114 or dickenj@gao.gov.

September 26, 2013

U.S. POSTAL SERVICE

Health and Pension Benefits Proposals Involve Trade-offs

What GAO Found

GAO has reported that Congress needs to modify the U.S. Postal Service's (USPS) retiree health benefit payments in a fiscally responsible manner. GAO also has reported that USPS should prefund any unfunded retiree health benefit liability to the maximum extent that its finances permit. Deferring funding for postal retiree health benefits could increase costs for future ratepayers and increase the risk that USPS may not be able to pay for these costs. Key considerations for funding postal retiree health benefits include:

- *Trade-offs regarding USPS's current and long-term financial condition:* One rationale for prefunding is to protect USPS's future viability by paying for retirement benefits as they are being earned. However, USPS currently lacks liquidity to fund required payments for prefunding retiree health benefits. To the extent prefunding is postponed, larger payments will be required later, when they likely would be supported by less First-Class Mail volume. No prefunding approach will be viable unless USPS can make the payments.
- *Possible consequences to USPS employees and retirees:* Fully funded benefits protect against an inability to make payments later and make promised benefits less vulnerable to cuts.
- *Allocating costs between current and future ratepayers:* Deferring payments can pass costs from current to future postal ratepayers. Allocating costs among different generations of ratepayers is complicated by the unfunded liability that was not paid for in prior years.
- *Funding targets:* An 80 percent funding target for postal retiree health benefits would effectively lead to a permanent unfunded liability of roughly 20 percent. An option could be to build in a schedule to achieve 100 percent funding in a later time period after the 80 percent level is achieved.

GAO has reported that USPS would likely realize large financial gains from its proposal to withdraw its employees and retirees from the Federal Employees Health Benefits Program (FEHBP) and establish its own health plan. According to USPS's estimates, these financial gains would significantly reduce its health benefits expenses and eliminate its unfunded retiree health benefit liability—with increased use of Medicare by retirees comprising most of the projected liability reduction. USPS also has projected that its proposal will increase Medicare spending. As Congress considers proposals for a USPS health care plan, it should weigh the impact on Medicare, which also faces fiscal pressure, and other issues, including establishing safeguards for assets of the USPS health plan and ensuring protections for plan participants are comparable to those in FEHBP.

GAO has also reported on key considerations regarding the release of any Federal Employees Retirement System (FERS) surplus to USPS. First, estimates of retirement benefits liabilities contain a significant degree of uncertainty and can change over time. Second, returning surpluses whenever they develop would likely result in an eventual unfunded liability. Alternative options to address funding surpluses include reducing USPS's annual FERS contribution either by amortizing the surplus over 30 years (which would mirror the treatment of deficits) or by offsetting the contribution against the full surplus each year until the surplus is used up.

Chairman Carper, Ranking Member Coburn, and Members of the Committee:

We appreciate the opportunity to be here today to discuss U.S. Postal Service (USPS) benefit issues in the context of proposed postal reform legislation. USPS continues to be in a serious financial crisis, with little liquidity in the short term and a challenging financial outlook in the long term as profitable First-Class Mail volume continues to decline. Members of this Committee have recently introduced comprehensive postal legislation that would, among other things, restructure the financing of postal retiree health benefits, including required payments to prefund these benefits; authorize USPS to collectively bargain with its unions to introduce a new health plan for postal employees; and restructure the funding of postal pensions, including addressing a potential surplus in funding postal pensions under the Federal Employees Retirement System (FERS).[1] In addition, USPS and others have offered proposals in these areas. This testimony will focus on issues related to (1) funding USPS retiree health benefits; (2) USPS's proposal for its own health plan outside of the Federal Employees Health Benefits Program (FEHBP) and (3) funding postal pensions including addressing a potential surplus in funding postal pensions under FERS.

This testimony is based primarily on our past work through July 2013 that examined USPS's financial condition and benefits. We have previously reported on (1) funding USPS retiree health benefits; (2) USPS's proposal to establish its own health plan outside of FEHBP and (3) funding postal pensions including addressing a potential surplus in funding postal pensions under FERS.[2] This testimony is based on work that was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe

[1] S. 1486, 113th Cong. (2013).

[2] GAO, *U.S. Postal Service: Proposed Health Plan Could Improve Financial Condition, but Impact on Medicare and Other Issues Should be Weighed before Approval*, GAO-13-658 (Washington, D.C.: July 18, 2013); *U.S. Postal Service: Status, Financial Outlook, and Alternative Approaches to Fund Retiree Health Benefits*, GAO-13-112 (Washington, D.C.: Dec. 4, 2012); *U.S. Postal Service: Allocation of Responsibility for Pension Benefits between the Postal Service and the Federal Government*, GAO-12-146 (Washington, D.C.: Oct. 13, 2011); *U.S. Postal Service: Strategies and Options to Facilitate Progress toward Financial Viability*, GAO-10-455 (Washington, D.C.: Apr. 12, 2010).

that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Each of the reports cited in this testimony provides detailed information on our scope and methodology.

Background

As table 1 shows, at the end of fiscal year 2012, USPS had $96.1 billion in unfunded benefits and other liabilities: $63.5 billion in unfunded liabilities for retiree health and pension benefits, as well as $15.0 billion in outstanding debt—the statutory limit—and $17.6 billion in workers' compensation liabilities. These liabilities have become a large and growing financial burden, increasing from 83 percent of USPS revenues in fiscal year 2007 to 147 percent of revenues in fiscal year 2012.

Table 1: Selected USPS Liabilities and Unfunded Pension and Health Benefit Liabilities, Fiscal Year End 2007 through 2012

(Dollars in billions)

Fiscal Year	Liabilities		Unfunded retiree health benefit and pension liabilities			
	Outstanding debt at the end of the fiscal year	Workers' compensation liabilities	Unfunded liabilities for retiree health benefits	Unfunded CSRS liabilities (surplus)[a]	Unfunded FERS liabilities (surplus)[a]	Total
2007	$4.2	$7.7	$55.0	$3.1	$(8.4)	**$61.6**
2008	7.2	8.0	53.5	3.3	(8.8)	**63.2**
2009	10.2	10.1	52.0	9.6	(6.8)	**75.1**
2010	12.0	12.6	48.6	7.3	(6.9)	**73.6**
2011	13.0	15.1	46.2	(1.7)	(11.4)	**61.2**
2012	15.0	17.6	47.8	18.7	(3.0)	**96.1**

Source: USPS.

[a] The Civil Service Retirement System (CSRS), which became effective on August 1, 1920, established a retirement system for certain federal employees. It was replaced by the Federal Employees Retirement System (FERS) for federal employees who first entered covered service on and after January 1, 1987. Pension and retiree health projections are sensitive to the economic and demographic assumptions used and can fluctuate from year to year due to actual economic and demographic outcomes (such as investment returns, salary increases, and mortality) being different than those predicted by the assumptions, and to changes in the assumptions themselves.

USPS's dire financial condition makes paying for these liabilities highly challenging. In the short term, USPS is in a financial crisis, has reached its $15 billion statutory borrowing limit, and lacks liquidity to fund needed capital investment. USPS has not made legally-required payments of $11.1 billion to prefund retiree health benefits and does not expect to make its required prefunding payment of $5.6 billion due at the end of this month. In the long term, USPS will be challenged to pay for its liabilities on a smaller base of profitable First-Class Mail. First-Class Mail volume has declined 33 percent since it peaked in fiscal year 2001, and USPS projects this volume will continue declining through fiscal year 2020.

Funding Postal Retiree Health Benefits

The Postal Accountability and Enhancement Act (PAEA) established the Postal Service Retiree Health Benefits Fund (PSRHBF) and required USPS to begin prefunding health benefits for its current and future postal retirees, with annual payments of $5.4 billion to $5.8 billion from fiscal years 2007 through 2016.[3] Subsequent USPS payments are required to be based on an actuarial approach to funding through fiscal years 2056 and beyond.[4] USPS has made a total of $17.9 billion in prefunding payments since the prefunding schedule began in fiscal year 2007, with the most recent prefunding payment that was made being for $5.5 billion in fiscal year 2010; a total of $33.9 billion in required prefunding payments remain from the 10 years of fixed payments. USPS's $5.5 billion retiree health benefit payment requirement that was originally due at the end of fiscal year 2011 was delayed until August 1, 2012.[5] USPS missed that payment, as well as the $5.6 billion payment that was due by September 30, 2012. USPS has reported that due to a low level of available cash, it will be unable to make its $5.6 billion payment due by September 30, 2013. The required prefunding payments that USPS does not make are reported as outstanding liabilities in USPS's financial statements. Looking forward, USPS has reported that low levels of liquidity will continue to exist, absent legislative actions by Congress.

[3] Pub. L. 109-435, § 803, 120 Stat. 3198 (Dec. 20, 2006), codified at 5 U.S.C. § 8909a.

[4] Under the prefunding mechanism established by PAEA, as implemented by the Office of Personnel Management (OPM), USPS payments to OPM would be projected to fund the liability over a period in excess of 50 years, from fiscal years 2007 through 2056 and beyond (with rolling 15-year amortization periods after 2041). PAEA established "fixed" prepayment amounts—meaning that the amounts were set by statute and did not vary with actuarial measurements of the cost of the benefits—in the first 10 years, from fiscal years 2007 through 2016, with actuarially determined payments thereafter. However, the payments required by PAEA were significantly "frontloaded," with the fixed payment amounts in the first 10 years exceeding what actuarially determined amounts would have been using a 50-year amortization schedule. According to OPM, as of Sept. 30, 2012, USPS's liability for retiree health benefits was $93.575 billion and the PSRHBF balance was $45.744 billion, with a resulting unfunded liability of $47.831 billion. For more detail, see GAO-13-112.

[5] Pub. L. No. 112-74, § 632, 125 Stat. 786, 928 (Dec. 23, 2011).

We have previously reported that Congress needs to modify USPS's retiree health benefit payments in a fiscally responsible manner.[6] Further, we also stated that USPS should prefund any unfunded retiree health benefit liability to the maximum extent that its finances permit. Deferring funding for postal retiree health benefits could increase costs for future ratepayers and increase the risk that USPS may be unable to pay for these costs.

Key considerations for Congress regarding the requirements for funding postal retiree health benefits include the following:

- *Trade-offs regarding USPS's current financial condition and long-term prospects:* One of the rationales for prefunding retirement benefits is to protect the future viability of the organization by paying for retirement benefits as they are being earned, rather than after employees have already retired. However, USPS currently lacks liquidity and postal costs would need to decrease, or postal revenues to increase, or both, to fund required payments for prefunding retiree health benefits. To the extent prefunding payments are postponed, larger payments will be required later, when they likely would be supported by less First-Class Mail volume. No prefunding approach will be viable unless USPS can make the required payments.

- *Fixed versus actuarially determined payments*: The retiree health benefits payment schedule established under PAEA was significantly frontloaded, with total payment requirements through fiscal year 2016 that were significantly in excess of what actuarially determined amounts would be.

- *Possible consequences to USPS employees and retirees*: Funded benefits protect against an inability to make payments later, make promised benefits less vulnerable to cuts, and reduce the risk that employee pay and benefits may not be sustainable and could be reduced.

- *Allocating costs between current and future ratepayers:* Deferring payments until later can have the effect of passing costs from current to future postal ratepayers. One of the rationales for prefunding is for current ratepayers to pay for retiree health benefits being earned by

[6] GAO-10-455.

current employees. The appropriate allocation of costs among different generations of postal ratepayers is complicated by what might be called the "legacy" unfunded liability that was not paid for in prior years.

- Funding targets: We have expressed concern about a proposed 80 percent funding target for postal retiree health benefits that would have the effect of carrying a permanent unfunded liability equal to roughly 20 percent of USPS's liability, which could be a significant amount.[7] If an 80 percent funding target were implemented because of concerns about USPS's ability to achieve a 100 percent target level within a particular time frame, an additional policy option to consider could include a schedule to achieve 100 percent funding in a subsequent time period after the 80 percent level is achieved.

USPS's Proposed Health Plan Outside of FEHBP

We recently reported on USPS's proposal to create a postal health care plan outside of FEHBP.[8] This proposal would offer health care coverage to postal employees and retirees (about 1 million of whom currently participate in FEHBP).[9] Under this proposal, initial benefits and postal employees' and retirees' share of premiums would first be established by USPS and subsequently, for union-covered employees, in collective bargaining.

USPS's proposed health care plan is designed to increase postal retirees' enrollment in Medicare as well as take advantage of Medicare subsidies

[7] For example, USPS's retiree health benefit liability at the end of fiscal year 2012 was $93.6 billion. Twenty percent of that is $18.7 billion.

[8] See GAO-13-658. Since this report was issued, USPS has discussed other options for a new USPS health plan that would be offered within FEHBP.

[9] The term "retirees" is used to refer to postal annuitants or any survivors of postal retirees who receive health benefits.

for employer-based prescription drug plans.[10] Specifically, it is designed so that all Medicare-eligible retirees would enroll in Medicare Parts A and B, with Medicare acting as the primary insurer for those enrollees and the USPS plan paying costs above what Medicare would cover for current retirees.[11] USPS's proposed plan would include prescription drug benefits that qualify it to receive a federal subsidy and drug discounts under Medicare Part D. Under one USPS option for funding this plan, USPS proposes that it would be authorized to invest plan assets without the approval of the Secretary of the Treasury in non-Treasury securities, such as stocks and bonds, as well as commodities, foreign currency, and real property. (See app. I for more information on the USPS proposed health plan.)

We have reported that USPS would likely realize large financial gains from its proposed health care plan. According to USPS's estimates, USPS would reduce its health benefits expenses and eliminate its unfunded retiree health benefit liability, primarily by increasing the use of Medicare by postal retirees once they are eligible for Medicare generally beginning at age 65. USPS estimated that its plan would reduce its retiree health benefit liability by $54.6 billion, with the increased use of Medicare accounting for most of this reduction. USPS also estimated that the plan would reduce its total annual required health care payments by $7.8 billion in the first year of implementation and by $33.2 billion over the first 5 years of implementation. In addition, some of the elements of the proposal—notably an option to allow USPS to invest health plan funds outside of Treasury securities, such as in stocks, commodities, and

[10] Medicare is the federally financed health insurance program for persons age 65 or over, certain individuals with disabilities, and individuals with end-stage renal disease. Medicare Parts A and B are known as Medicare fee-for-service. Medicare Part A covers hospital and other inpatient stays. Medicare Part B covers hospital outpatient, physician, and other services. Medicare beneficiaries have the option of obtaining coverage for Medicare services from private health plans that participate in Medicare Advantage—Medicare's managed care program—also known as Part C. All Medicare beneficiaries may purchase coverage for outpatient prescription drugs under Part D, either as a stand-alone benefit or as part of a Medicare Advantage plan.

[11] Postal employees pay Medicare taxes and therefore may become eligible for Medicare coverage generally at age 65. Eligible retirees are not required to enroll in Medicare. As of the end of 2011, about 8 percent of Medicare-eligible postal retirees were not enrolled in Medicare Part A and 22 percent were not enrolled in Medicare Part B—slightly lower than the nonpostal FEHBP population, of which 11 percent and 25 percent did not enroll in Parts A and B, respectively.

foreign currency—would add uncertainties that could reduce funds available for its employees' and retirees' future health care.

We have reported that under USPS's health care plan as designed for year one, postal employees and retirees would have coverage for a similar package of services as under selected FEHBP plans, and the level of coverage would be similar for many services, with some exceptions (e.g., services received outside of USPS's approved network). We estimated that, had the proposed USPS plan been implemented in 2013, most employees and retirees would have had similar or lower premiums compared to selected FEHBP plans; but total costs—premiums and costs for the use of care—could be higher for some.

We have also reported that withdrawing the approximately 1 million USPS employees and retirees from FEHBP, which would be required under USPS's proposal, would reduce FEHBP's enrollment by an estimated 25 percent.[12] Despite the significant change in enrollment, most nonpostal enrollees would likely not be affected by a USPS withdrawal beyond what selected FEHBP plan representatives expect to be small increases or decreases in premiums. However, USPS's withdrawal could lead the small number of FEHBP plans with primarily postal enrollment to withdraw from the program. For example, if the 4 plans with 70 percent or more postal enrollment discontinue participation in FEHBP under a USPS withdrawal, an estimated 1 percent (about 29,000) of the approximately 3 million nonpostal enrollees in FEHBP would need to select a new health plan.

As Congress considers proposals for a USPS health care plan, it should weigh the impact on Medicare as well as other issues, including establishing safeguards for plan assets and ensuring FEHBP-comparable protections for plan participants. The primary policy decision for Congress to make with respect to such proposals is whether to increase eligible postal retirees' use of Medicare. USPS projects that its plan would increase Medicare spending by an average of $1.3 billion per year over the first 5 years of its plan—about 0.2 percent of Medicare's annual costs of more than $550 billion. Our report also noted that Medicare is on a fiscally unsustainable path over the long term. A USPS health plan that

[12] Our estimates of enrollment changes used data on enrolled contracts, not the number of covered lives.

would add costs to Medicare would have to be weighed alongside the fiscal pressure already faced by Medicare.

If Congress decides to move forward with USPS's proposed health plan as part of a broader reform package, we have identified other important policy issues that also should be addressed. Specifically, Congress should consider:

- safeguards for USPS health plan fund assets by placing appropriate constraints on their asset allocations (for example, limiting investments to Treasury securities, including inflation-indexed Treasury securities; or, to the extent that more risky assets are permitted, using a conservative approach to setting the prefunding discount rate);
- standards for the disposition of any surplus health plan assets that reduce the risk of a new unfunded liability emerging in the future (for example, standards for amortizing any surplus to mirror the amortization of any unfunded liability);
- designation of an independent entity responsible for selecting actuarial assumptions used to determine the health plan's funded status; and
- protections for postal employees and retirees that are comparable to those under FEHBP, including a formula for retirees' contribution to health costs.

The Potential FERS Surplus

USPS had an estimated FERS surplus of $3.0 billion at the end of fiscal year 2012, according to the Office of Personnel Management (OPM), and OPM will be calculating an updated estimate for the end of fiscal year 2013. USPS has reported an estimate that its FERS surplus would have been substantially larger if its FERS liability had been estimated using postal-specific demographic and pay increase assumptions.[13] USPS has stated that it believes, as a matter of equity, its FERS liability should be estimated using USPS-specific pay increase and demographic

[13] United States Postal Service, *2012 Report on Form 10-K* (Washington, D.C.: Nov. 15, 2012) 37.

assumptions instead of government-wide pay increase and demographic assumptions. As we have reported, legislation would be needed to return to USPS any FERS surplus.[14]

As we also have reported, we would support a remedy to the asymmetric treatment of FERS surpluses and deficits under current law.[15] A conservative approach to permit USPS to access any FERS surplus would be to use it to reduce USPS's annual FERS contribution by amortizing the surplus over 30 years (which would mirror the legally required treatment of deficits). A second approach would be to reduce USPS's annual FERS contribution by offsetting it against the full amount of surplus each year until the surplus is used up; this would be comparable to what occurs for private-sector pension plans. We have previously suggested that any return of the entire surplus all at once should be done with care. A one-time-only return of the entire surplus should be considered as a one-time exigent action only as part of a larger package of reforms and restructurings. Otherwise, returning surpluses whenever they develop would likely eventually result in an unfunded liability.

Key issues for Congress to consider in connection with the potential USPS FERS surplus include:

- *Fluctuations in estimated liabilities:* Estimates of liabilities for retirement benefits contain a significant degree of uncertainty and can change over time.
- *Whether to use USPS-specific assumptions to measure USPS's FERS liability:* We support using the most accurate numbers possible. If USPS-specific assumptions are used in estimating USPS's FERS liability, we suggest that they also be used in estimating USPS's CSRS and retiree health liabilities. We suggest that if USPS-specific assumptions are to be used, that the assumptions be recommended by an independent body (such as OPM's Board of Actuaries).

[14] GAO-12-146.

[15] GAO, *Responses to Questions for the Record; Committee on Homeland Security and Governmental Affairs, February 13, 2013, Hearing on "Solutions to the Crisis Facing the U.S. Postal Service"* (Washington, D.C.: Apr. 5, 2013). Under current law, USPS must fund towards any FERS deficit but does not benefit from any FERS surplus. See GAO-12-146, p. 37.

- *Other liabilities:* While USPS had an estimated FERS surplus of $3.0 billion dollars at the end of fiscal year 2012, it had an estimated CSRS deficit of $18.7 billion at the same time. Both estimates could change if USPS-specific assumptions are used. In addition, as noted earlier in Table 1, USPS also has an unfunded liability for retiree health benefits and liabilities for workers' compensation and its debt to Treasury, for a total of $96.1 billion of liabilities and unfunded benefit liabilities.

In closing, we continue to believe that a comprehensive package of legislative actions is needed so that USPS can achieve financial viability and assure adequate benefits funding for more than 1 million postal employees and retirees. Chairman Carper, Ranking Member Coburn, and Members of the Committee, this concludes my prepared statement. I would be pleased to answer any questions that you may have at this time.

GAO Contact and Key Acknowledgments

For further information about this statement, please contact Frank Todisco, Chief Actuary, FSA, MAAA, EA, Applied Research and Methods, at (202) 512-2834 or todiscof@gao.gov; or John E. Dicken, Director, Health Care at (202) 512-7114 or dickenj@gao.gov. Mr. Todisco meets the qualification standards of the American Academy of Actuaries to render the actuarial opinions contained in this testimony regarding the measurement issues, funding issues, and risks associated with pension and retiree health care obligations. Contact points for our Congressional Relations and Public Affairs offices may be found on the last page of this statement. In addition to the contacts named above, Lorelei St. James, Director, Physical Infrastructure Issues; Teresa Anderson; Susan Barnidge; Kenneth John; Jaclyn Nelson; Kristi Peterson; Steve Robblee; Friendly Vang-Johnson; Betsey Ward-Jenks; and Crystal Wesco made important contributions to this statement.

Appendix I: Key Elements of the Proposed U.S. Postal Service Health Care Plan

Element	Description
100% participation of eligible retirees in Medicare Parts A and B	The U.S. Postal Service's (USPS) plan is designed so that all Medicare-eligible retirees would enroll in Medicare Parts A and B. Those who do not enroll would have their benefits reduced by the amount Medicare would have paid had the individual enrolled. As is the case under the Federal Employees Health Benefits Program (FEHBP), Medicare would serve as the primary payer of health care costs, and for existing retirees, the USPS plan would cover 100 percent of any costs above the amounts covered by Medicare Parts A and B.
Prescription drug benefits that qualify the plan for federal subsidies and drug discounts	USPS would design the prescription drug benefits under its plan to qualify as an Employer Group Waiver Plan (EGWP) under Medicare Part D. This would qualify USPS to receive—for those eligible for Medicare—a federal subsidy from the Medicare program for drug costs, a discount from pharmaceutical companies for brand name drugs, and federal coverage for drug costs above a catastrophic limit.
Introduction of two new tiers of coverage	The proposed plan would include four coverage tiers: self only, self and spouse, self and children, and self and family. Premiums for each tier would be set according to the claims experience of the group. USPS's proposed addition of two tiers (self and spouse and self and children) to the options available under FEHBP would be to reflect the various stages of family status that participants may experience over the course of their career and retirement.
Purchasing plan administration services from a single vendor through a competitive bidding process	USPS would contract with a single vendor to administer its plan; that vendor would negotiate with providers for payment rates, process claims, and provide wellness and disease management programs.
Requirement that future retirees be subject to plan deductibles and cost-sharing upon enrolling in Medicare	For employees retiring a year or more after the USPS plan becomes effective (i.e., "future retirees"), Medicare would be the primary insurer once the enrollee becomes eligible, and the USPS plan would cover costs above what Medicare pays. However, future retirees would be required to meet the USPS plan deductible and pay coinsurance.
USPS Health Benefits Fund	Under one option of USPS's proposal (which USPS refers to as "Scenario 2"),a its health plan would be financed by a newly created fund called the Health Benefits Fund (HBF) that would include: (1) the entire Postal Service Retiree Health Benefits Fund that would be abolished upon its transfer to the HBF; (2) the balance of the fund that finances FEHBP allocable to contributions by USPS, postal employees and retirees, including any reserve fund amounts; (3) USPS contributions under its health plan; (4) contributions of postal employees and retirees under the USPS health plan; (5) any interest on HBF investments; (6) any other USPS receipts allocable to the USPS health benefits plan; and (7) appropriations based on the service of officers and employees of the former U.S. Post Office Department. Under its proposal, USPS would be authorized to invest HBF assets without the approval of the Secretary of the Treasury in non-Treasury securities, such as stocks and bonds, as well as commodities, foreign currency, and real property. Also, USPS indicates that HBF assets could not be used for (1) loans to USPS, such as to enable it to remain solvent; (2) USPS payments to the federal government, such as for pensions and workers' compensation; or (3) to finance USPS investments or USPS nonpostal initiatives to generate revenue. In any year when the amount of HBF assets exceeds USPS's estimated actuarial liability for retiree health benefits, USPS could authorize the surplus amount to be transferred to the Postal Service Fund that finances most USPS expenses, provided that such authorization is made pursuant to a recommendation by a majority of the Committee overseeing the HBF.

Element	Description
USPS funding of retiree health benefits	USPS would continue to prefund retiree health benefits, but under a purely actuarial approach, without the fixed (non-actuarial) payments required under current law through 2016. Payments to the HBF would be based on the "normal cost" and amortization of any unfunded liability or surplus of its retiree health care liabilities over an amortization period ending at the later of 40 years after implementation or 15 years from the then-current year.

Source: GAO analysis of USPS information.

[a]USPS has also proposed another option for financing its health plan (which USPS refers to as "Scenario 1") under which retiree health benefits would continue to be financed from the Postal Service Retiree Health Benefits Fund (PSRHBF).

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Testimony of

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President, National Association of Letter Carriers

to a hearing titled "Outside the Box: Reforming and Renewing the Postal Service, Part II – Promoting a 21st Century Workforce" by the

Senate Committee on Homeland Security and Governmental Affairs

September 26, 2013

My name is Fred Rolando and I am the elected President of the National Association of Letter Carriers (NALC), a union that represents nearly 200,000 active City Letter Carriers who live and work in every state and jurisdiction of the United States. Thank you for the opportunity to testify today on ways to promote a high quality postal workforce in the 21st Century. I will note that the members of my union are also very interested in the service and rate-setting issues addressed in the first part of this hearing, which was conducted on September 19, 2013.

In this written testimony, I will address the origins of the current crisis, provide our views on the bill proposed by the Chairman and Ranking Member of this committee (S. 1486, the Postal Reform Act of 2013) and address all the issues raised in both the first and second parts of your hearing. In my oral statement, I will focus more narrowly on the workforce issues you have asked me to address in your invitation. Both statements are submitted on behalf of the nearly 270,000 active and retired letter carriers who have voluntarily joined our union, including more than 90 percent of all active City Letter Carriers.

I. Introduction

As the Postmaster General said at last week's hearing, the Postal Service is in a financial crisis. We've heard this now for more than six years, and, to a casual observer, it probably sounds like nothing has changed. However, the reality is that the actual operating results of the Postal Service – the best indicators of organizational health – have improved remarkably this year. Indeed, while the Postal Service's last quarterly financial statement reported a $3.9 billion loss for the year so far, the uniquely onerous Congressional mandate to pre-fund future retiree health benefits accounted for more than 100% of the loss ($4.2 billion). In other words, the USPS has returned to operational profitability following the worst recession in 80 years.

This year we are finally seeing some promising signs in the business of the Postal Service. As the current frustratingly slow economic recovery struggles to take hold, total mail revenue actually increased by 3.6% during the quarter, compared to last year, while expenses declined. A slight loss in letter mail revenue (-0.9%) was more than offset by the 8.8% increase in shipping revenue. Nothing better illustrates the double-edged nature of the internet when it comes to the Postal Service – yes, it is displacing some letter mail (for paying bills), but advertising (Standard Mail) volume is now growing and e-commerce is driving a major surge in package deliveries. At the same time, thanks to a lot of hard work by the employees of the Postal Service who have endured massive job cuts since 2007 (200,000 jobs) and who have driven productivity to record highs, and thanks to a round of collective bargaining that has dramatically cut labor costs for the Postal Service, the Postal Service has adapted to reduced mail volume. On city letter carrier routes, for example, letter carriers are now serving an average of 616 delivery points per route per day, 25% more than they did in 2007, as the number of routes has been slashed in response to the loss of volume. But this downsizing has come at a cost of slower delivery times and reduced access to retail services. Fortunately, Congress has rejected the Postal Service's worst ideas for service cuts – the elimination of Saturday and door delivery. This committee should do so too.

I raise these points not to claim that the Postal Service is entirely out of the woods, but rather to remind the Members of this Committee that it is not 2009 anymore. The Postal Service is not in a free fall. The Great Recession is mostly over and the internet promises to create business, not just destroy it. Now is not the time to radically dismantle the Postal Service or undermine its invaluable first-mile and last-mile networks. Now is the time for intelligent reform that will promote innovation and preserve the high-quality workforce and networks that have made the Postal Service both the most popular and trusted agency in the Federal government as well as a major boon to the national economy.

Indeed, you have asked us to think outside of the box. We urge you to do the same. Congress should consider the following questions: What other national needs might the Postal Service meet with its unmatched universal networks? How else can we use post offices and letter carriers to satisfy civic and commercial needs? We have suggested promoting democracy by expanding voting by mail across the country. We have called for using letter carriers to read utility meters instead of asking households to pay for the installation of expensive smart-readers. We support helping the 40 million Americans who the FDIC says are "unbanked or under-banked." We could offer inexpensive electronic payment systems and low-cost savings accounts at post offices in rural and urban communities that lack access to private banks. Such postal savings accounts might be used to voluntarily fund a National Infrastructure Bank that has broad bipartisan support. Let's not just debate downsizing proposals, let's debate how we can find ever more useful ways to serve the American people and the American business community as we have done for more than 235 years.

II. Origins of the Crisis

The crisis facing the Postal Service is now in its seventh year. Although there are some serious technological factors at play, the scale and severity of the crisis is largely due to actions taken by Congress in the recent past. In 2006, the Congress passed and President George Bush signed the Postal Accountability and Enhancement Act (PAEA) of 2006. That legislation mandated a massive level of pre-funding of future retiree health benefits with a schedule of annual payments totaling $59 billion over the first 10 years with additional pre-funding thereafter to be amortized over the next 40 years. The PAEA also placed strict price controls on the postage rates charged for magazines, catalogues, and letter mail (so-called market-dominant products). The new law gave the Postal Service a one-time-only option to adjust postage rates in 2007 to build the cost of the new pre-funding mandate into its prices before the new price index system kicked in (in an omnibus rate proceeding before the Postal Regulatory Commission). But the onset of what turned out to be the worst recession in 80 years led the USPS to forego that option. So USPS pre-funding costs soared at a time when the economy crashed and its revenues plummeted.

Though enacted at a time when the Postal Service was earning profits, the PAEA had a disastrous effect on the Postal Service. In a kind of perfect storm, the agency's finances were devastated by the pre-funding mandate, the price controls and the Great Recession -- which decimated the housing and finance industries that generate so much mail volume. On top of all this, surging fuel costs and the loss of First Class Mail to electronic bill-paying and internet communication exacerbated the losses.

In the popular media and, unfortunately in many of the statements issued by Members of

Congress, the fiscal crisis at the Postal Service is often portrayed as a simple story of technological change. Although internet diversion is a serious problem, it has not been the main driver of USPS losses in recent years. As the table below indicates, nearly 80% of the Postal Service's $41 billion in reported losses stem from the $32 billion in pre-funding costs since 2007:

The Policy Legacy of the 2006 Postal Reform Bill (PAEA)

Pre-funding Payments to the Postal Service Retiree Health Benefit Fund (PSRHBF) vs. Reported Net Income

2007-2012*

Year	PSRHBF Expenses ($bil)	Reported Net Income ($bil)	Assets in PSRHBF ($bil)
2007	$8.358	-$5.142	$25.4
2008	$5.600	-$2.806	$31.8
2009*	$1.400	-$3.794	$34.2
2010	$5.500	-$8.505	$40.6
2011*	$0.000	-$5.067	$42.5
2012	$11.1	-$15.900	$45.0
Totals	**$31.958**	**-$41.214**	----

Prefunding expenses account for nearly 80% of reported USPS losses over the past six years since they were first imposed in 2007.

Notes: * Legislation adopted in 2009 reduced the 2009 pre-funding expense from $5.4 to $1.4 billion. Legislation adopted in 2011 deferred the $5.5 billion payment for 2011 until August 2012. USPS was unable to make the $11.1 bil payment in 2012.

Source: Annual Reports of the Postmaster General, 2007-2012.

The negative impact of these costs continues. In the first three quarters of the current fiscal year, the Postal Service earned an operating profit of $330 million, but reported a loss of $3.9 billion after recognizing a $4.2 billion expense for pre-funding. That is, pre-funding accounts for more than 100% of the reported loss so far this year. Meanwhile, as other delivery companies were able to raise rates to handle rising gasoline prices and other overhead costs, the Postal Service was prohibited from raising rates above the very low levels of inflation experienced during the Great Recession:

Consumer Price Index:
CPI-Postage vs. CPI-Private Delivery

Year	CPI-Postage	CPI-Delivery Services (private delivery)
2007	2.5%	6.4%
2008	3.4%	14.7%
2009	4.9%	-6.2%
2010	2.8%	14.2%
2011	3.9%	11.7%
2012	3.5%	5.3%
Avg. Inc. (2007-2012)	**3.5%**	**7.7%**

Source: Bureau of Labor Statistics, Consumer Price Index.

- Postage rates for most USPS volume were capped at the general rate of inflation even though the pre-funding mandate caused costs to soar.
- Shared sacrifice requires the use of a more relevant price index: CPI for Delivery Services which tracks delivery prices in the private sector.

The pre-funding mandate, which no other business or independent agency faces, not only crippled the Postal Service's finances, it also led the Postal Service to pursue relentless downsizing and service cuts that drove even more mail volume out of the system. Rather than use its borrowing authority to retool and to capture new volume in the booming e-commerce industry, or to develop new products to offer through its unmatched first-mile and last-mile delivery networks, the Postal Service has used it all to cover pre-funding costs. Worse, postal management has been hunkered down in crisis mode ever since the mandate took effect, devising ever more draconian reductions in service that threaten to plunge the Service into a death spiral -- where declining volume begets service cuts, prompting further volume losses and more service cuts.

Over the past few years, the USPS has removed tens of thousands of collection boxes and has reduced the operating hours in more than 10,000 post offices, weakening its first-mile network and driving away more business. And it wants to degrade its last-mile delivery network by cutting Saturday delivery for most of its customers. Indeed, last week the Postmaster General renewed his request to reduce delivery to five days a week, after Congress blocked his earlier plan to unilaterally override the law and the will of Congress by implementing five-day service for letter mail and six-day service for packages in August. Thanks to the leaders and Members of this Committee, he did not get away with his brazenly illegal plan.

As the Committee deliberates over postal reform, we urge you to repeal or fundamentally modify the PAEA's unintentionally destructive policies on pre-funding and pricing, and to take action to prevent the Postal Service from downsizing itself into a death spiral by saving six-day delivery. These steps alone will go a long way toward saving the Postal Service. Other reforms, such as a fundamental restructuring of the Postal Service's Board of Governors, executive management and regulatory environment would also help the Service better compete for e-commerce volume and to use its unmatched networks to offer new services. Sadly, on virtually all these counts, S. 1486 fails to propose what is necessary.

III. NALC's Views on S. 1486

The National Association of Letter Carriers strongly opposes the adoption of S. 1486 as currently drafted. We do so because S. 1486 would effectively double down on the disastrous Bush administration policy to mandate massive prefunding of future retiree health benefits at the expense of service and the Postal Service's ability to innovate and grow in the future. It also provides for major downsizing measures to pay for this prefunding policy.

The relief provided by the three-year moratorium on pre-funding payments in S. 1486 is more apparent than real since the USPS has not been able to make the unaffordable payments in recent years; it won't be able to do so in the future when the pre-funding mandate is re-imposed with both normal cost and amortization payments for future retiree health benefits. The bill replaces one form of unaffordable pre-funding (the PAEA's scheduled payments) with another form of unaffordable pre-funding. Other businesses and agencies do not have to prefund retiree health at all; it is unreasonable to make the Postal Service do so. These normal and amortization payments, when combined, will certainly exceed the scheduled payments required under current law (which now average $5.6 billion annually) in 2016 and thereafter. At that point, the USPS would default and we'd be right back where we are today.

S. 1486 fails to protect the Postal Service's unique networks, which hold much promise for future growth, and instead calls for major downsizing even before the savings negotiated in the most recent round of collective bargaining have been allowed to materialize. Worse, rather than permanently addressing this crushing pre-funding burden, and from our standpoint, to add insult to injury, the bill would give USPS tools to slash postal employees' pension and health benefits by making these federal employee benefits subject to interest arbitration. This would set up a morale-killing two-tier workforce and poison the productive and innovative culture needed to strengthen USPS. Astonishingly, we were not consulted about these proposed changes to our rights as federal employees or to our collective bargaining process -- before the bill was introduced. That bargaining process has been hugely successful for more than 40 years and has produced huge benefits for the country and the Postal Service's stakeholders: Postage rates have remained among the lowest in the developed world, taxpayer subsidies have been eliminated and the quality of service has remained excellent – as both consumer surveys and public opinion surveys have confirmed.

S. 1486 would facilitate the dismantling of the Postal Service's mail processing and delivery networks, weakening both our first-mile (post office) and last-mile (delivery) capacity, in order to preserve a pre-funding policy that makes no sense. This would seriously harm the 7.5 million Americans who work in private companies that rely on the USPS. The bill would:

- destroy 80,000 full- and part-time jobs in both cities and rural areas, after a one-year delay, by eliminating Saturday mail delivery (harming millions of businesses who want it) and give the Postmaster General authority to eliminate additional days of delivery in the future;

- slash tens of thousands of additional jobs, after a two-year delay, by allowing USPS to reduce service and delivery standards and to close hundreds of mail processing facilities and thousands of post offices;

- mandate the elimination of door-to-door delivery of mail for all businesses and new households, and call for the phase out of door delivery to millions of established households – threatening at least 16,500 additional jobs; and

- impose unfair reforms to the FECA workers compensation program that would leave injured federal workers with the worst long-term injuries vulnerable to impoverishment when they reach their Social Security retirement ages.

This massive down-sizing and the bill's assault on postal employee benefits are not necessary. They are being driven by an extreme retiree health financing policy that no rational business would adopt. The Postal Service has already pre-funded decades of retiree health premiums, more than perhaps any other enterprise in America. Indeed, USPS has already set aside an estimated $49 billion for such premiums, approximately 50% of total expected costs over the next 90+ years.

As noted above, the Postal Service had been making great progress over the past year -- its package business is booming, and commercial mail is recovering as the housing market and the national economy show signs of revival. It should not be forced to forgo new vehicles and investments in new technology, new innovations and new products in order to put even more money into the Postal Service Retiree Health Benefits Fund (PSRHBF). Just as the budget sequester has thwarted a strong economic recovery, the adoption of more misguided austerity through a bad postal reform bill would make things worse, not better.

We need postal reform that will create jobs and innovation, not cut more jobs and reduce service for the American people. The 30 members of the Senate who have co-sponsored S.316, the Postal Service Protection Act of 2013, have taken the right approach. That bill would strengthen the Postal Service, promote innovation and, most importantly, resolve the retiree health and pension policies that have crippled the Postal Service in recent years. We urge the Committee to use that bill as a starting point for debate over postal reform.

There are many policy alternatives to the negative proposals in S. 1486 – measures to increase postal revenues, cut costs and cover future retiree health liabilities without massive service and job cuts. I am happy to outline a number of these alternatives here.

IV. NALC Proposals to Promote Growth and Innovation

A. Reform the Mandate to Prefund Future Retiree Health Benefits

The Postal Service is the most financially sound, supposedly failing company in America. Its pension obligations (under CSRS and FERS) are nearly fully-funded (95%), even in the face of outdated pension cost allocation methods developed by OPM in the 1970s that are grossly unfair to the Postal Service (according to independent, private sector audits that are discussed below) and the use of federal-wide actuarial assumptions that over-state likely postal liabilities.

As mentioned previously, the Postal Service has also prefunded nearly 50% of its future retiree health benefits. No other civilian agency in the executive branch has pre-funded these costs at all, and according to a recent Towers Watson survey of Fortune 1000 companies, only 38% of such private companies prefund at all and the *median* level of funding is just 37%. In the private sector, pre-funding is voluntary. Responsible companies pre-fund when they are profitable or use their surpluses in their pension funds to cover such costs, as encouraged by the tax code.

Unfortunately, the PAEA's uniquely burdensome prefunding mandate is slowly killing the Postal Service. The excessive level of pre-funding required by the PAEA has consumed all of the Postal Service's borrowing authority and has pushed the agency to the verge of insolvency. No private company would have funneled tens of billions of dollars into a retiree health fund in the midst of a deep recession. The Postal Service needs immediate and significant relief from this mandate – without it, no other reform will make a difference.

There are three major reforms that Congress should adopt to resolve the pre-funding menace to the Postal Service:

1) <u>Cover the Cost of Retiree Health with the True CSRS Postal Pension Surplus</u>. During the 112th Congress, bills offered in both the House and Senate, sought to protect future taxpayers from future postal retiree health liabilities by permitting the Postal Service to use postal pension surpluses in the Civil Service Retirement and Disability Fund (CSRDF) reported by independent audits (USPS-OIG/Hay and PRC/Segal) to cover the cost of future pre-funding. Indeed, the only-bipartisan postal bill considered by the

House of Representatives (H.R. 1351) in the 112th Congress, which drew 230 co-sponsors from both parties, called for fairly and accurately measuring the Postal Service's pension surplus in the postal CSRS account of the CSRDF and transferring the surplus to the PSRHBF. That bill never got a vote in the House. In the Senate, the original bills offered by Sens. Carper and Collins (S. 1010 and S. 353) that were later combined to create S. 1789 contained similar language on the CSRS surplus. However, concerns that transferring funds from the CSRDF to the PSRHBF would present budget scoring problems led to the elimination of the provision from S. 1789 – not because the USPS receives any taxpayer money, but because the Postal Service is "off budget" under the arcane (and in this case misguided) accounting rules used by CBO and OMB. Senators Carper and Collins may have also have been swayed by a September 2011 GAO report that deemed the OPM's methods as acceptable. However, the same report acknowledged that the PRC and OIG methods were "reasonable" and that the choice of methods used for pension allocations is rightly a "policy decision" for Congress.

The decision to leave the CSRS transfer provision out of S. 1789 prevented significant relief from the pre-funding burden – which may have driven the bill's authors to target the elimination of 18% of all postal jobs and to lay the groundwork for the elimination of Saturday delivery two years from now. It is crucial to reverse these legislative decisions, and to address the problems that led to them, as we tackle postal reform in the 113th Congress. However, as I outlined in the testimony I submitted to this Committee in February, this can be done in a way that minimizes the seeming impact on the deficit that would result from a large transfer from the CSRDF to the PSRHBF. Indeed, it may not be necessary to transfer any funds at all to significantly reduce the cost of pre-funding. I will briefly summarize how this can be done (for details please refer to my February testimony):

a) Congress should instruct the Office of Personnel Management to adopt modern, private sector actuarial methods when conducting its annual valuation of the CSRS postal sub-account within the Civil Service Retirement and Disability Fund and use Accounting Standard Codification No. 715. (FASB -ASC 715, *Compensation—Retirement Benefits* from the Financial Accounting Standards Board), as recommended by the Postal Regulatory Commission's report *on Civil Service Retirement Cost and Benefit Allocation Principles* prepared by respected experts of the Segal Company (June 29, 2010).

b) In order to minimize any budget impact of mandating the use of fair actuarial methods and assumptions, Congress should repeal Section 1848(h)(2)(C) of USC Title 5, which requires the transfer of any postal pension surplus to the USPS Retiree Health Benefit Fund following valuations in 2015, 2025, 2035 and 2039.

A repeal of the transfer provision would minimize any budget score associated with a policy of accurately and fairly defining the Postal Service's pension obligations and give policy-makers up-to-date and accurate information on the Postal Service's legacy costs. It makes sense because the PSRHBF will not need the surplus funds for decades – and the surplus pension funds might never be needed if Congress enacts the reforms outlined below to properly invest the PSRHBF (reform 2) and to find ways to reduce future retiree health benefit costs (reform 3).

c) Congress should repeal the PAEA's fixed schedule of pre-funding payments and replace it with the two-tier prefunding payments called for in S. 1789 (normal cost and amortization costs), but establish a right to access the fairly calculated CSRS postal surplus in the future to cover the cost of retiree health benefits if the PSRHBF should ever be exhausted. (The 80% funding target and the immediate access to the PSRHBF to cover current retiree health premiums in S. 1486 should be retained in any new legislation.)

d) Congress should require the OPM Board of Actuaries to take the accurately measured CSRS postal surplus into account when calculating the unfunded liability for postal employee retiree health benefits, a step that would eliminate the need to make amortization payments over the next ten years or more. (In practical terms, the USPS would make a normal cost payment each year to the PSRHBF and the PSRHBF would cover the cost of current postal retiree health premiums – resulting initially in a growing PSRHBF, before taking into account the fund's earnings.) This instruction would apply the best practice of private-sector pension funds to the Postal Service. Indeed, the tax code allows companies to apply surplus pension funds to the cost of post-retirement health liabilities (see section 420 of the Internal Revenue Code).

e) In order to address false claims that might be raised by some that reforms such as those described above represent "taxpayer bailouts," Congress should adopt the Statutory PAYGO reforms proposed by the Obama administration to the Super Committee established by the 2011 Budget Control Act. Section 104 of the administration's submission called for an amendment to the PAYGO act to treat the transactions of the Postal Service Fund as "budgetary effects," thereby measuring Postal Service transactions on a unified budget basis for PAYGO purposes.

2) Invest the PSRHBF in the Thrift Savings Plan. The PSRHBF is unique in the federal government. No other independent agency has a retiree health fund. Although it differs

from so-called VEBA plans (Voluntary Employee Benefit Associations) in the private sector because retired postal employees are guaranteed retiree health benefits by the FEHBP law even if the balance in the PSRHBF goes to zero, it is very similar to such plans since its assets are dedicated to cover benefits for a specific group of people with a tie to a single employer. In this case, the PSRHBF is dedicated to pay the Postal Service's share of health insurance premiums for retired postal employees -- starting in 2017 (under current law).

Unfortunately, the PSRHBF is invested solely in low-yielding Treasury securities – and given that long-term health care costs are expected to grow faster than the interest rates payable by Treasury securities for the foreseeable future, the unfunded liability will almost certainly keep growing over time. No VEBA in the private sector would invest its assets so conservatively, especially since the annual cash requirement for the PSRHBF ($3 billion per year) is a fraction of the $49 billion in assets. The GAO has warned about the risk of investment losses if the assets of the PSRHBF were invested in securities other than Treasury securities. But with the several-decade-long investment horizon involved and the small annual cash flow needs of the PSRHBF, this risk is minimal. (A real world test of this occurred with the collapse of financial markets in 2008-2009 – huge losses incurred by the TSP's funds were recovered within a few years.)

In an ideal world, the PSRHBF would be held on the Postal Service's books and invested appropriately (in a properly diversified portfolio of stocks, bonds, real estate, etc. overseen by a professional investment manager) to minimize the PSRHBF's unfunded liability – and therefore minimize any amortization payments from the USPS in the future. Transferring the PSRHBF to the off-budget Postal Service would present massive budget scoring problems (unless the budgetary effects proposal outlined above is adopted before the postal reform bill is enacted) and the Treasury Department has traditionally opposed the investment of government trust funds in private securities.

However, NALC believes there is a way for the PSRHBF to earn higher, private sector-based returns without moving it from the OPM's books – which should actually reduce the federal deficit. The PSRHBF could be invested in the index funds offered by the Thrift Savings Plan. The Federal Retirement Thrift Investment Board already invests a pool of nearly $300 billion of federal and postal employee retirement savings in these funds – so investing the funds of the PSRHBF, which also holds assets dedicated to post-retirement benefits, would not be setting a new precedent. Towers Watson has estimated that the PSRHBF would earn more than 7% annually if it were invested in the TSP's Lifecycle 2050 Fund over the long term. That is much greater than the 3 -3.5% returns paid lately on Treasury bonds.

3) Take steps to reform FEHBP to reduce the cost of retiree health costs. Generally, the OPM and the FEHBP program have done a relatively good job in controlling health care costs. Indeed, the federal government's health care costs are lower than those of other large employers in the private sector, and the FEHBP program has restrained health care inflation better than employer plans in the private sector. Nevertheless, there is more that could be done to significantly reduce health care costs – which could reduce the cost of prefunding retiree health benefits.

The Postal Service has asked Congress to let it leave the FEHB Program and set up its own health care program. The postal unions, including the NALC, oppose leaving FEHBP since virtually all the savings the USPS thinks it can achieve outside of FEHBP could be achieved inside the program. We are currently engaged in very productive discussions with the Postal Service and other stakeholders to develop proposed reforms to FEHBP that would apply private sector practices and significantly reduce or even eliminate the unfunded liability for future retiree health benefits.

It is urgent that Congress take action to repeal or reform the pre-funding mandate. We cannot imagine any member of the Senate, regardless of party or ideology, who would accept such a mandate being applied to a single private sector employer in his or her state. Yet because it is applied to a federal agency, it is ignored. But the negative impact it has on the Postal Service is hurting the entire postal industry. Of the eight million workers in our industry, just over a half-million work for the USPS. The vast majority of the workers in our industry work in private companies across the country. The pre-funding mandate is not just dragging the USPS down; it's weakening an entire industry that employs workers in every state of the union.

B. Embrace Six-day Last Mile Delivery as a Core Function

The core competence and core asset of the Postal Service as an enterprise is its unmatchable, six-days-per-week, last-mile delivery network. It is a strategic asset that must be protected as we seek ways to return the Postal Service to financial health. It should not be sacrificed to maintain the disastrous pre-funding policy introduced in 2006, or even the modified pre-funding policy that is proposed by S. 1486 because degrading the Postal Service's core asset makes no business sense.

Indeed, we urge the Committee to mandate six-day delivery in Title 39 – and remove the possibility that Congressional appropriators might inappropriately seek "unified budget" savings by eliminating the six-day requirement even though the USPS receives no taxpayer money.

The Postmaster General has put forth a number of flimsy arguments in support of his five-day mail delivery proposal, even as he has failed to be fully forthcoming on the job losses his plan will entail. I fully addressed all these arguments in the testimony I submitted to the Committee's hearing in February. That testimony showed that the PMG has:

- Overstated the potential savings of going to 5-day delivery – a conclusion confirmed by the PRC – and understated the potential revenue loss (according to its own consultants and market research);
- Wrongly suggested that the move to 5-day delivery would not slow the delivery of mail, even though mail would not be collected or processed on Saturdays;
- Offered incomplete and misleading market research in support of the cut in delivery service -- failing to fully acknowledge that millions of businesses say they want and need six-day delivery;
- Failed to admit that delivering packages-only on Saturdays would drive up its parcel prices to uncompetitive levels by foregoing the benefits of shared networks that spread overhead costs across all products (parcels, letters, periodicals, etc.); and
- Misled the Congress on the number of jobs to be lost under his plan to eliminate Saturday delivery – saying it would cost 22,500 jobs when he informed the postal unions that nearly 82,000 jobs would be eliminated.

The Congress should not permit the Postal Service to commit managerial malpractice by allowing it to devalue its most important and unique asset – the ability to reach 152 million households and businesses every-day, six days a week. It makes no sense as a business strategy and it would endanger the long-term viability of the Postal Service by driving away customers.

C. Pricing and products reform

In the absence of the pre-funding mandate, the introduction of a streamlined system of rate regulation would have made a lot of sense in 2006. Replacing the costly and time-consuming system of setting postage rates through months of expensive litigation between competing sets of mailers was a laudable goal. Unfortunately, the Congress saddled the Postal Service with a huge new mandate at the same time it implemented the price cap on its rates. The cost of the pre-funding mandate was never built into the Postal Service's prices because the USPS did not conduct the one-time, final omnibus rate case called for in the PAEA. (The USPS did not want to raise rates in the midst of the recession.) Even without the crushing burden of pre-funding, the cost of mail delivery on a unit basis is bound to rise as internet diversion reduces mail volume, but the Postal Service cannot charge mailers the true cost of delivering the mail. This pricing regime is not sustainable and is contributing to the self-defeating downsizing that threatens to destroy a key part of the nation's economic infrastructure.

At a minimum, the Postal Service should be given the right to adjust its rates with a one-time proceeding before the Postal Regulatory Commission. The omnibus postage rate review and adjustment that was authorized by the PAEA, but that did not happen in 2007, should be conducted in 2013. If Congress insists on the prefunding mandate, then it is only fair that at least some of its cost should be built into the postage rates the Postal Service charges its customers. Such a one-time rate case is needed to provide reasonable balance to the huge sacrifices postal employees have made in recent years.

But in addition, the Postal Service must be able to generate greater revenues to balance the cost-cutting it will continue to pursue. No struggling enterprise can mindlessly downsize its way back to health. It must have a growth strategy and be able to generate new revenues.

There are three ways that the Postal Service can increase revenue: grow the existing business in sectors of the mailing industry that are expanding (package delivery, returns and e-commerce), better align prices to reflect costs (pricing reform), and find new uses of the Postal Service's networks that can help finance and preserve the valuable last mile delivery networks that the country depends on for commerce, communication and voting. The USPS is already doing the first and will continue to succeed so long as it does not destroy its own comparative advantage by degrading its last-mile network. But Congress must enact reforms to help USPS increase revenues in the second and third ways.

First, on pricing reform, the case can be made to eliminate the price cap altogether, as the regulator in Great Britain did in 2012. Postal operators no longer have the ability to abuse their monopolies – there is an electronic or physical alternative to every service they provide. The USPS has no market power whatsoever – if it raises rates too high, customers will leave the mail system. There is market discipline in place. On the other hand, mailers legitimately want some protection against capricious rate increases and desire predictability when making volume decisions. Despite this the USPS needs greater flexibility to set rates that will cover its costs.

This could be achieved by reforming the price index use for market-dominant products. It should be updated and must be based on an appropriate benchmark index. The Consumer Price Index for All-Items is not the correct index. The Postal Service is part of the national delivery industry, a transport-based, energy-intensive industry that has unique characteristics. Although the USPS is by definition more labor-intensive than private companies like FedEx and UPS – we deliver to 150 million addresses six days a week, not 15 million addresses five days a week – the USPS faces the same cost pressures as those companies. At a time of soaring energy costs, the rates charged by private companies that provide delivery services have increased at more than twice the rate of postage -- see the table in section II above. If the

USPS is to preserve its networks, it must be given pricing flexibility. Congress should modernize the price indexing system and replace the CPI-All Items with a different index. The mailing industry has objected to the CPI for Delivery Services as too volatile to provide the kind of predictability needed. NALC therefore recommends that Congress limit postage prices to a more stable, yet appropriate index – the Producer Price Index for Delivery and Wharehouse Services (PPI-DWS). This sector of the economy includes the Postal Service in the Bureau of Labor Statistics' classification system. As such, the PPI-DWS is an appropriate private sector benchmark. Its adoption would also help with the "budget score" of postal reform legislation.

Second, on products, the overly restrictive definition of a postal product contained in the PAEA should be liberalized. The reforms proposed in S.1789 in 2012 show the way. Opening the mail to beer and wine sales makes sense. But the range of services the Postal Service could provide is much greater and it should be given the right to find new uses for its networks. Whether its meter reading for utility companies as an alternative to expensive smart meters, or partnerships with private banks to serve Americans in rural and depressed urban areas where commercial banks have no presence, or recycling computer parts in partnership with private companies, the Postal Service needs greater commercial freedom. We believe an innovation commission as proposed by Senator Sanders makes great sense. That commission should study the possibility of using the nation's post office network as the backbone of a National Infrastructure Bank, and Congress should consider giving every American the right to vote by mail in federal elections. A more entrepreneurial Postal Service could do what the Post Office has done since it was mandated by the Constitution – evolve to meet the changing needs of the country. But to achieve a more entrepreneurial culture, the governance structure of the Postal Service needs to be reformed. I will turn to this topic next.

D. Governance reform

At a moment when the Postal Service faces the gravest crisis in its history, its Board of Governors will soon have five vacancies. The gridlock that has hampered the appointment process in general has really damaged the Postal Service in particular. When you consider that the terms of two of the five commissioners on the Postal Regulatory Commission have also expired, the appointments problem is even deeper. But what truly makes the problem a crisis is that the PAEA's guidelines for appointments to the Board have not been followed.

The PAEA amended the law to require that "at least 4 of the Governors shall be chosen solely on the basis of their demonstrated ability in managing organizations (in either the private or the public sector) that employ at least 50,000 employees. Although all of the governors who serve are honorable people, none of them meet this requirement. As our advisers at Lazard Co. reported to us, the Postal Service lacks a Board with the kind of business experience needed to create a vision for a revitalized Postal Service – nor does it have the kind of executive talent needed to execute such a vision. Instead, the Board has approved the "shrink to survive' strategy that Lazard believes is doomed to fail.

NALC calls on Congress to overhaul the governance structure of the Postal Service to give it the best chance to achieve growth and innovation. NALC will work with any leadership team that is equipped to develop a strategy for growth and to partner with postal employees and their unions to secure the long-term viability of the Postal Service.

E. Addressing the Cash Crisis: Return of the FERS Pension Surplus

The reforms we have advocated in this testimony are essential to the survival of the Postal Service well into the 21st Century. But we also face a short-term solvency crisis, even though it has been largely manufactured. (Let us not forget that there is now nearly $49 billion in the PSRHBF, which could be tapped to avert insolvency.) Sadly, the prefunding mandate, the Great Recession, and the misguided business plan of current postal management have left the Postal Service seriously short of cash and starved of needed investments. A good example of this damage is the Postal Service's recent decision to lease new vehicles rather than permanently replace its aging fleet of delivery trucks – a penny-wise, pound-foolish decision driven by the lack of investment capital and borrowing authority.

In order to prevent an economically damaging interruption of service and to give the reforms outlined above the time they need to work, Congress must also restore the liquidity the Postal Service needs to operate. Fortunately, there is a surplus in the Postal Service's FERS pension account that nobody disputes. That surplus declined from $11.4 billion in 2011 to $3.0 billion in 2012 due to a decline in the OPM's discount rate, but is expected to rise again this year as interest rates have increased. It would rise further if S. 1486's proposal to use postal-specific assumptions in the valuation process is adopted. Congress should change the law to allow for this transfer from the FERS postal account in the CSRDF to the Postal Service – to pay down its debt and make the investments it needs to serve the country and remain healthy.

V. Conclusion

Thanks again for inviting NALC to testify at this hearing. NALC is committed to working together with both parties to fashion a bi-partisan reform bill that will preserve a strong and vibrant Postal Service for decades to come. Thank you for considering our views.

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STATEMENT OF

JOHN F. HEGARTY, NATIONAL PRESIDENT

NATIONAL POSTAL MAIL HANDLERS UNION

BEFORE THE

SENATE COMMITTEE ON

HOMELAND SECURITY

&

GOVERNMENTAL AFFAIRS

OUTSIDE THE BOX: REFORMING AND RENEWING THE POSTAL SERVICE, PART II – PROMOTING A 21ST CENTURY WORKFORCE

September 26, 2013

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Chairman Carper and members of the Committee. On behalf of the National Postal Mail Handlers Union, I am John Hegarty, National President of the Mail Handlers Union since 2002. I appreciate the opportunity to testify today and to present our views.

The NPMHU represents more than 45,000 craft employees, the overwhelming majority of whom work in the Postal Service's large processing facilities. Our members often perform the most dangerous, dirty, and difficult jobs in the postal system. We sort mail on machines that sometimes are a block or more long. We drive the forklifts and other heavy machinery. Our members are the first to touch the mail when it arrives for processing, and often are the last to touch it when as it winds its way to delivery facilities.

Processing is time sensitive and labor intensive. Further reductions in the number of processing facilities or in the hours worked by mail handlers will have a direct and, we believe, a dire impact on the timely processing and delivery of all classes of mail. This is especially true for mail items that need prompt processing and delivery, such as not only Priority, Express, or First-Class Mail, but also medicines from various pharmacy companies, DVDs through Netflix or similar companies, and newspapers or magazines and advertisements that are time sensitive.

The Postal Service has faced some severe economic realities. The worst American recession since the Great Depression and a larger-than-expected decline in mail volume caused, in part, by electronic diversion have combined to test the Postal Service's financial well-being. In the past three years, the Postal Service has not been able to meet its statutory obligation to continue the pre-funding of its retiree health benefits.

To the extent that the Postal Service has had to downsize because of these economic conditions, that downsizing has already occurred. The Postal Service has eliminated almost 300 processing plants in the past five years, and the Postal Service has reduced its employee complement by more than 300,000 employees in the past twelve years.

To the extent that postal employees need to contribute to the financial turnaround of the Postal Service, all postal employees have already sacrificed. My members, as well as other postal employees, have had their wages frozen for the past two years, and we have had our employee contributions increased for both health insurance and retirement. There has been a 25% reduction in the number of mail handlers, and the remaining employees are working harder, and more productively, than at any time in American history. Many members of the Mail Handlers Union – now more than 5,000 – are working in non-career, part-time jobs at reduced pay rates. And thousands of career mail handlers and other employees have been involuntarily excessed or transferred to other work locations, often hundreds of miles away, and have had to up-root their homes and their families because of closings and consolidations of the postal network.

Last week, the Postmaster General testified that the Postal Service had reduced costs by $16 billion during the past few years. As a service industry with labor-intensive costs, it should be clear that most of those savings have come from its employees. Indeed, in April 2011, during House testimony, the PMG projected a cost savings of $3.8 billion from the negotiated four and one-half year collective bargaining agreement that it had only recently reached with the American Postal Workers Union. Similar although not identical agreements resulted from arbitration proceedings with the other three postal unions, including the NPMHU, and thus a fair estimate would be that approximately $12 billion of the Postal Service's expense reductions over the past few years have come from its workforce. Mail handlers and other postal employees have contributed to the rejuvenation of the Postal Service. The question must be asked, what have other stakeholders contributed?

First and foremost, it is now time for Congress to do its share. Most of the losses announced by the Postal Service during the last few years have nothing to do with a failing business model or the obsolescence of the mail. In 2006, Congress mandated that the Postal Service pre-fund future retiree health benefits for the next 75 years, and also mandated that the Postal Service do so within 10 years. This is something that no other public agency or private firm does, or would ever do, if allowed to adopt and implement a rational financial plan. For the first few years after 2006, as mail volume and postal revenue were booming, the Postal Service met its obligations, and as a result, the Postal Service now has $49.1 billion in its Retiree Health Benefits Fund. That means that more than 50% of its long-term retiree health care obligations are already funded, which is substantially more than the private-sector average of 30% funding, and immeasurably more than the federal government's zero-based funding of its own retiree health obligations.

The facts are even brighter with regard to retirement. The Postal Service not only has fully funded all of its future retirement costs, but in fact the Postal Service has overfunded its share of FERS or the Federal Employees Retirement System. Congress needs to act immediately to adjust the FERS account using postal-specific data and then return the overpayments to the Postal Service. Nor should there be any severe restrictions on how the Postal Service uses those monies; it should be allowed to pay down some of its debt and invest in programs and technologies to grow the postal business.

With all respect, the proposed legislation recently introduced by Chairman Carper and Ranking Member Coburn fails miserably on both of these issues. With regard to retiree health, the bill does not eliminate the remaining pre-funding requirement, but rather simply defers these unreasonable and unaffordable payments until 2016. Although the bill correctly reduces the overall funding to 80% of total liability and allows for the payment of current retiree health premiums from the Retiree Health Benefits Fund, the annual payments required from the Postal Service under S. 1486, starting in 2016, actually might surpass USPS obligations under current law.

With regard to pension, the draft bill unacceptably caps the FERS refund at only $6 billion, even if the actual surplus is considerably higher. S. 1486 also fails to require an accurate calculation of the postal surplus attributable to CSRS or the Civil Service Retirement System, in the manner reasonably proposed by S. 316, which has been introduced by Senator Sanders and now has 30 co-sponsors in the Senate. And in one of its most unjustified provisions, S. 1486 would subject the continuation of federal health and retirement benefits for postal employees to future negotiation and arbitration, thereby threatening the future solvency and stability of the entire Federal Employees Health Benefit Program and threatening to single-out new postal employees for grossly unfair treatment on the subject of employee benefits.

The bill currently pending before this Committee also is deficient on issues relating to the maintenance of service by the Postal Service. S. 1486 would allow for the continued dismantling of the mail processing and delivery network that always has been the backbone of the Postal Service. Allowing the Postal Service to reduce service standards or eliminate days and/or points of delivery will only lead to lower-quality and slower service. Inevitably, this will cause additional losses in business from mailers and the American public, which in turn will lead to deeper cuts and a continuing crisis. What Congress needs to mandate is a moratorium on additional closings or consolidations of mail processing facilities, a continuation of six-day and door-to-door delivery, and a re-emphasis on the continuing importance and vitality of the Postal Service. If Congress shows the resolve to protect the Postal Service as a long-standing and necessary American institution, the mailing public will respond with its business and its continuing support. By itself, such reaffirmation of the public's commitment to the Postal Service would help to ensure future business development around the Postal Service, thereby contributing to a positive rather than a negative financial outlook.

A contribution also is necessary from the nation's mailers, who seem to be blinded by potential rate increases to the detriment of the overall survival of the Postal Service. As Inspector General Williams testified last week, the Postal Service's main competitors have been increasing their rates by two times the rate of inflation, with little negative impact on their business. The Mail Handlers Union sees no reason that the major mailers and the general American mailing public should not be asked to contribute their fair share to the future success of the Postal Service, perhaps by loosening the cap on rates to something more than the Consumer Price Index or by measuring inflation with another index that more realistically reflects the cost pressures faced by the Postal Service.

As currently drafted, S. 1486 also contains a wholly unjustified and largely unexamined reduction in workers compensation benefits. As proposed, the legislation would severely penalize injured federal workers with the worst injuries, by forcing them into a retirement system that is based on their final salary even though they were prohibited from earning increases in salary because of their on-the-job injuries. These injured workers also would be unable to save through the Thrift Savings Plan or earn Social Security credits while receiving workers compensation. Even worse, these provisions have been included in this bill without any hearings into their efficacy, and without the support of any experts with a working knowledge about the actual impact of these changes. These provisions need to be removed from any bill that is being seriously considered.

On a more positive note, the NPMHU fully supports legislation that would allow the Postal Service to use its retail, processing, and delivery network to provide non-postal services, especially as a means of assisting governmental agencies or other nonprofit entities in reducing their own costs. As an important part of the nation's communications and logistics system, there is no reason that the network-based resources of the Postal Service should be not be shared with other organizations whose primary aim is to serve the American public.

Finally, let me address the Postal Service's proposals to change its retirement and health insurance programs.

-- With regard to retirement, there is no basis whatsoever for the Postal Service's proposal to leave the FERS system and adopt a separate defined contribution program. As already noted, the Postal Service's retirement obligations are fully funded, if not overfunded, and do not impose an unacceptably large burden on postal finances.

-- As for health insurance, the Postal Service continues to call publicly for a USPS-only health plan, but that proposal is inconsistent with several principles that determine the NPMHU's approach to health care for its members and other postal employees. First, the NPMHU will insist that the Postal Service remain part of the Federal Employees Health Benefit Program, to ensure the continued success of that program, and to take advantage of the size and bargaining power represented by the Office of Personnel Management. Second, the NPMHU will insist that its members continue to have a wide range of choices in health insurance plans, so that individual employees can choose which plan is best based on their family situation and other circumstances. Within these guidelines, the NPMHU continues to work with the Postal Service and other stakeholders on a comprehensive approach to health care that will allow mail handlers and other postal employees to rely, to a larger extent than under current law, on the Medicare benefits for which the employees and the Postal Service already have paid. It is hoped that this comprehensive approach also will resolve contentious issues relating to the pre-funding requirements for the Retiree Health Benefits Fund.

We look forward to continuing to work with Congress going forward, to not only help the Postal Service survive, but to grow and thrive. I would be happy to take your questions.

National Association of Postmasters of the United States

Testimony of

Robert J. Rapoza

National President

Hearing Before

Senate Committee on Homeland Security and Governmental Affairs

Washington, D.C.

September 26, 2013

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Chairman Carper, Ranking Member Coburn and Committee members, thank you for once again inviting the National Association of Postmasters of the United States (NAPUS). As always, our nation's Postmasters seek to provide constructive input as the Committee continues to tackle the daunting task of ensuring the continued viability of the United States Postal Service. In December, I will complete my two terms as President of NAPUS and will return to Hawaii. Over my almost four years of leading Postmasters, though I have been frustrated by the lack of legislative movement, I truly appreciate your dedication to seeing that our universal postal system is restored to solvency and relevance.

In my February testimony, which is part of the Committee's official hearing record, I identified the core elements that Postmasters believe must be part of postal relief legislation. Those elements include: promoting revenue generation through innovation and credible pricing; funding retiree health benefits and pensions fairly and realistically, without undermining retirement security and health coverage; and preserving universal service. These goals are attainable and, to a modest degree, could have been realized through enactment of S. 1789, the consensus postal bill the Senate passed during the previous Congress. Regrettably, the stars, or should I say, the House of Representatives was not aligned; so, we now find ourselves continuing the crusade.

These hearings are integral to this quest and, therefore, I welcome your invitation. I would begin my testimony by observing that the Postal Service and the mail revenue that finances its operation are highly sensitive to the state of the economy. Recent data seems to indicate that mail revenue has stabilized, if not grown slightly. Moreover, absent the 2006 retiree health prefunding requirement, the Postal Service would have been in the black during the previous fiscal quarter. Consequently, gloom-and-doom forecasts should be moderated, and we should use the economic recovery as an opportunity to produce thoughtful and constructive legislation, and not scare off potential postal customers.

Mr. Chairman, I concluded my February 13 testimony with the admonition: "The future of the Postal Service is in your hands." As you may recall, you amended my remark by commenting that the future of the Postal Service is in <u>our</u> hands. I agreed with your retort; so, at the outset of today's testimony I would like to share with the committee some sacrifices endured by Postmasters and the communities they serve. These sacrifices have contributed to postal cost reductions. Nevertheless, please keep in mind that, last year, approximately 840 million Americans conducted 1.7 billion postal transactions at postal retail facilities. The Postmaster workforce has shrunk by more than 5,000 positions over the past year, and another 4,500 will be eliminated by September 2014. Additionally, almost 14,000 communities, served by about one-half of the nation's post offices, face dramatic cuts in post office hours. Ironically, such hour cuts curtail retail revenue generation. In fact, a very recent Postal Inspector General posting suggested the post office reductions and closings may have cost the Postal Service passport application revenue. Moreover, many Postmasters will shoulder the burden of managing multiple post offices, with strained resources and limited training. It is also important to note that non-career postal employees will now staff most of the part-time post offices. These postal employees, many who are NAPUS members, are known as Postmaster Reliefs

(PMR). They are not afforded employer-provided health benefits; however, we hope the Committee, as it develops the health benefits portion of postal legislation, can address the unmet health needs of Postmaster Relief personnel.

Beginning this year, Postmasters and other managerial and supervisory employees have absorbed an increased share of their Federal Employees Health Benefits Program (FEHBP) premiums. And, by 2015, Postmasters will be making the exact same percentage contribution toward health insurance as other federal employees and annuitants: 28 percent of the total premium. Moreover, Postmasters have been denied merit-based salary adjustments for the past three years. Furthermore, Postmasters are not entitled to cost-of-living-adjustments. So, Mr. Chairman, I think it is crucial to understand that Postmasters continue to do their part on behalf of the Postal Service and its future.

The Committee invitation to this hearing suggested that I focus on workforce issues, including how employees can better promote postal services in a digital marketplace, and an examination of managerial postal benefits. Before commenting on these two topics, I would appreciate the chance to address a number of items addressed in pending S. 1468.

I would like to begin by discussing the absolute necessity for the Postal Service to be empowered and prodded to become more innovative and entrepreneurial. As I mentioned in February's testimony, the growth in the small package market needs to be exploited by the Postal Service. We cannot simply ride the growth wave. Post offices need to be involved in marketing and preparing postal products, not just their acceptance and delivery. Real-time, instant messaging of when mail is available for pickup should be a valued-added service. In addition, as the Postal IG testified last week, mobile imaging of delivery confirmation is not far off. These products yield real benefits to small- medium- and home-based businesses. In addition, post offices can provide e-connectivity to the entire federal government, as well as local and state governments, and even private institutions. Digital document authentication and identity verification are also services that post offices can and should offer. NAPUS believes that section 302 of the legislation provides the Postal Service with essential latitude in developing innovative products and services by which the Service can re-establish relevance to millions of Americans.

I would like to return to the importance of post offices and Postmasters to small businesses – one of the fastest growing sectors of our economy. A June 2013 Postal Service Office of Inspector General Audit report on Small Business Growth pointed out, "Postmasters are typically at the forefront of the interactions with local small businesses, either by providing service, addressing service issues, or selling Postal Service products and services." *Business Connect©* was designed to facilitate Postmasters' engagement with such businesses and, in its own manuals, the Postal Service highlighted that Postmasters are a valuable resource to aid customers with their postal needs.

Postmasters, the managers-in charge of post offices, are the most effective postal personnel in generating much-needed revenue and marketing the new postal products that will inevitably be promoted by the Postal Service. In fact, the IG concluded that it should be the policy of the agency to increase the priority that Postmasters place on generating revenue, including allocating of more time to Postmasters to sell products and services. In addition, the agency should provide better coordination between Postmasters and the Postal Service's business development staff. Pivotally, the IG called on the Postal Service to "leverage the Postmasters' community status by encouraging Postmasters to join local civic associations, providing fertile ground for markcting postal products and services." In essence, innovative product or service develop is insufficient; there must be an effective strategy to market the products or services, and Postmasters are the obvious conduit for such a strategy.

I also suggested in my February testimony that the local post office is the obvious choice for the distribution of the vast array of governmental programs, including issuing and reloading government-issued cash cards. These forms of aid are essential, particularly in the wake of natural disasters. Post offices could also be the preferred venue for tailored financial services for the unbanked and provide such services in broadband-deficient areas.

As this Committee is aware, Postmasters have a strong commitment to postal accessibility, particularly to postal-reliant communities prevalent in rural areas and small towns. The consensus legislation that the Senate passed last year included a number of bipartisan provisions that would help safeguard postal accessibility, direct the Postal Service to implement retail service standards, and equip the Postal Regulatory Commission with the authority, in limited circumstances, to overturn a Postal Service decision to close a post office. These provisions were authored by former Committee members Jerry Moran and Susan Collins. In addition, current members Tester, Begich, Levin, Pryor, and Landrieu also co-authored the relevant provisions – sections 203, 204 and 205 of S. 1789. NAPUS strongly urges the Chairman and Ranking member to include these provisions in the legislation when a bill is brought before the Committee.

Section 301 would provide the Postal Service with greater pricing flexibility and allow it to more expeditiously adjust rates. One of the more contentious issues in the 2006 postal law was the overly restrictive mechanism used to adjust postage. Indeed, the hard consumer-price-index (CPI) cap has proven to be injurious to postal operations, finances, and capital investment; moreover, it has not stemmed the tide of mail leaving the postal system. As the Postal IG last week pointed out, the price cap has limited applicability in the economic environment in which the Postal Service needs to compete and raise revenue. The hard cap precludes the Postal Service from being equipped to compete with multiple communications platforms. Additionally, the so-called postal monopoly is an anachronism due to multi-dimensional competition with the digital platform. Finally, flexible pricing of market dominant products would help the Postal Service pay the expense of continuing to prefund the retiree health obligation. NAPUS would argue that the hard rate cap failed to anticipate the acceleration of mail diversion, the Great Recession, and the impact the prefunding requirement would have on the Postal Service.

At this point, I would like to address those issues which the Committee seeks to highlight at today's hearing. Obviously, the motivation for sections 101, 102, 103, 104, and 105 in

S.1486 is to reduce Postal Service employee benefit obligations. NAPUS could support some of the sections; however, others raise blazing red flags.

Section 101 would provide a refund of up to $6 billion that the Postal Service has already overpaid on behalf of its Federal Employee Retirement System (FERS) beneficiaries. In addition, the section would direct the Office of Personnel Management to recalculate the Postal Service's pension liability based on postal-specific demographics. NAPUS strongly supports the refund of any overpayment the Postal Service may have made on behalf of its employees; however, if it were to be determined that the overpayment exceeds $6 billion, the higher amount should be reimbursed to the Postal Service. In order to make the surplus calculation more accurate, the Committee might want to consider making the calculation within 60 days of enactment, or take the average of 60 days prior to enactment, the date of enactment, and 60 days post-enactment.

Section 102 would permit the Postal Service to deny newly hired postal employees the opportunity to participate in FERS. Notwithstanding our objection to postal desertion from a very efficient, successful, and fully-funded retirement program, it is unclear from the language how Postmasters or other managerial and supervisory employees would be treated under section 102 because front-line managers do not collectively bargain. While Postmasters do have a "consultative process," the consultation procedure places my members at a profound disadvantage in discussing compensatory and workplace issues with Postal Service Headquarters. Therefore, NAPUS cannot risk the assurance and stability of retirement benefits for future Postmasters by elimination a statutory retirement protection program.

I would remind the Committee that the FERS program is extremely fair to the employer and to the employee. In 1984, FERS replaced the Civil Service Retirement System (CSRS). Unlike CSRS, FERS is portable, meaning a postal employee is not bound to a 25- or 30-year postal career to accrue an annuity. Under FERS, a postal employee vests in the basic retirement annuity (FERS), which provides a modest annuity, after five years. The Thrift Savings Plan (TSP), which is completely portable, provides an automatic 1 percent of salary employer contribution, combined with an employer-employee match of up to 5 percent of salary. The employee can make non-matching contributions that exceed the 5 percent threshold. Finally, a postal employee fully participates in Social Security. The FERS program remains one of the most successful and balanced retirement programs in the nation. Subjecting retirement benefits to collective-bargaining, which may include sporadic modifications of a 401K-type match, would undermine the retirement security of future postal employees.

Section 103 would restructure the Postal Service's retiree health prefunding schedule to make the legally required payments more manageable. While NAPUS believes Congress should revisit the obligation in its entirety, we believe that amortizing 80 percent of the projected liability over a 40-year period, beginning in 2016, is a step in the right direction. NAPUS believes, however, in the absence of dramatic legislative relief from the congressionally mandated payment – beyond the schedule proposed in section 103 –

the Postal Service should be able to add a factor to its postage rate adjustments that explicitly includes the required payment, and this factor should not be counted against any postage rate cap.

Section 104 would subject employee health coverage – not just the Postal Service's premium contribution to collective-bargaining. At the outset, let me remind the Committee that Postmasters do not collectively bargain and NAPUS does not sponsor an FEHBP health plan. This being stated, NAPUS members are deeply concerned the Postal Service expertise to administer its own health plan, and the financial strength to self-insure it. In fact, the unease about self-insurance was raised in the July 2013 Government Accountability Office (GAO) analysis of a postal-only health plan. OPM also raised this concern. NAPUS is also anxious about the uncertainty of continued comprehensive health coverage for retirees, particularly those who are not yet eligible for Medicare.

Under current law, postal retirees have premium protection through the FEHBP's weighted average premium formula, and benefit modifications are managed through OPM's annual call letter. Such safeguards are not afforded under section 104. Once postal employees are forced out of FEHBP, they are prohibited to return as a retiree because to continue FEHBP coverage in retirement, the annuitant must have five years of FEHBP coverage immediately preceding retirement. So, enrollment in a postal-only plan outside of FEHBP would preclude FEHBP retirement health coverage. As an aside, I would note that a couple of agencies – the Federal Deposit Insurance Corporation and the Federal Reserve – took a gamble with their own health plans in the 1980s; they lost the wager and were forced to buy their way back into the FEHB in the 1990s. I do not have confidence the USPS would be able to buy its way back into FEHBP if it leaves the program and its own health plan crashed and burned. Hence, postal employees and retirees would be in dire jeopardy.

The GAO also raised a major concern that employees with higher than average health claims and non-Medicare eligible retirees are at greater risk under a postal-only health plan. Consequently, we strongly believe that postal employees and retirees should retain their eligibility to participate in the FEHBP.

It is important to note that the GAO examination of the USPS health proposal failed to quantify any savings attributable through efficiencies, innovation, or enhanced provider leverage. In addition, the GAO included a very important cautionary note about the potential treatment of retirees under a postal-only health plan because they would lose specific statutory protections. It is important to note the OPM effectively manages competition among a diverse menu of FEHBP plans, and contains premium increases more effectively than most employer-sponsored private sector plans.

As noted with regard to section 102 of the bill and at the beginning of my comments on postal health benefits, Postmasters and front-line managers do not collectively bargain. Section 104 provides Postmasters and other front-line managers the opportunity to maintain coverage under the FEHBP. Nevertheless, I remain concerned that if a USPS plan were to be implemented, Postal Headquarters could financially penalize managers who exercise their option to remain in FEHBP, through inflated employee contributions. Furthermore, if Postmasters were financially compelled to be part of a postal-only plan, it is possible that collectively bargained plans could be able to negotiate restrictive enrollment or contain union-specific benefits and, as a result, employee-bargained plans would be limited to members of the bargaining unit, and, thereby closed to Postmasters. Each of the four collective-bargaining units currently sponsors their own FEHBP health plans. Management groups do not sponsor health plans. Consequently, if Postmasters and other managerial employees were precluded from participating in one of the employee-organization plans, the USPS would have to craft a plan for them. Inasmuch as Postmasters and managers tend to be older than rank-and-file postal employees, it is quite logical we would be an expensive risk pool to insure. In fact, NAPUS did sponsor a plan through the 1980s; however, we recognized that Postmasters, as a distinct group, were costly to insure and, as a result, our health premiums were not affordable. It made insurance sense for Postmasters to be part of a larger pool of FEHBP participants. There is real potential in a postal plan for Postmasters and frontline managers to be segregated in a distinct pool and be subjected to excessive premiums, inferior benefits, or both. This is a real fear that Postmasters have.

Section 105 would require OPM to offer optional FEHBP plans for Medicare-eligible postal enrollees who participate in Medicare parts A and B. It is my understanding that the unique characteristic of this proposal would be that the plans would be priced in such way as to account for Medicare participation. Consequently, the premium would be discounted on the basis that FEHBP would supplement or explicitly coordinate its coverage with Medicare. While NAPUS recognizes these plans would be voluntary for Medicare-participating postal retirees and would remain within the FEHBP, we are anxious about coverage design and treatment of FEHBP deductibles and co-payments, which are now waived for double-covered enrollees. In addition, the combination of sections 104 and 105 could have the unintended consequence of isolating postal retirees who are not eligible for Medicare, and drive premiums up for the plan in which they participate.

As a footnote to this proposal, the Committee should be aware that a government-wide proposal to reduce FEHBP premiums for Medicare-eligible participants was included in the Medicare Catastrophic Coverage Act of 1988 (PL 100-360); however, the entire act was later repealed by the Medicare Catastrophic Coverage Repeal Act of 1989 (PL101-234). Obviously, more effective coordination of FEHBP and Medicare coverage has been a longstanding issue for policymakers. For example, the Omnibus Budget Reconciliation Act of 1990 (Public Law 101-508) included a provision that applied Medicare part A provider payment limits to all FEHBP participants over the age of 65, even if FEHBP enrollees were not Medicare participants. And the Omnibus Budget Reconciliation Act of 1993 (Public Law 103-66) applied the Medicare part B limits to the same group of annuitants. The 1993 law also required that Medicare-providers accept FEHBP payments for 65-and-over non-Medicare participants on the same basis as if they were in Medicare; the law also applied Medicare payment limits to non-Medicare doctors treating 65-and-older FEHBP patients. Consequently, there has been a strong relationship between FEHBP reimbursement policy and Medicare charges. The application of Medicare limits has helped contain FEHBP costs. However, although the rate is the same, in one instance, FEHBP alone pays, and in the other, Medicare pays first and FEHBP just covers the balance. Consequently, it is clear that annuitants with similar health risks who are covered by both Medicare and FEHBP are less expensive for FEHBP to insure than those in FEHBP alone. In its report, the GAO estimated that about 22 percent of Medicare-eligible postal retirees have not enrolled in Medicare part B and 8 percent were not in Medicare part A. I believe that providing for retroactive automatic enrollment, without penalty, for those eligible for Part A should be done. These retirees already paid for such coverage through the Medicare payroll tax. In all likelihood, they participate in CSRS, which does not provide for automatic enrollment and their failure to file the requisite forms may have been an oversight. In contrast, FERS are automatically enrolled by virtue of Social Security participation.

The previously referenced Reconciliation Act of 1990 included a provision that required OPM, in consultation with the Department of Health and Human Services, to create a system to identify individuals who are entitled to Medicare benefits. Assuming such a system is still operational, OPM should run a data match between Medicare-entitlement and postal retirees who are in CSRS, and enroll in Medicare part A those who are entitled to the benefit, without penalty. To encourage Medicare part B enrollment, NAPUS believes the late enrollment penalty should be waived, and the same Medicare part B "hold harmless provision" afforded to FERS postal participants should be applied to CSRS postal participants. The hold-harmless provision assures the participant that an increase in the Medicare part B premium will not result in a decrease in his or her monthly annuity. An annuity decrease would occur if the part B premium increase exceeds the retirement COLA.

I understand there may be some interest in modeling postal retiree health coverage after the retiree health plan established by the "Big Three" automotive manufacturers. In 2007, the plan was made available to retired members of the United Automobile Workers union. I would respectfully suggest serious caution in this approach. First, the automotive retiree health plan was established as a "trust"; there is no assurance of continued funding of the plan, particularly if trust investments falter. Once trust funds are exhausted, retiree health benefits cease. Second, because the trust was established pursuant to three independent UAW collective-bargaining agreements, the health benefits are denied to managers and employees who are not represented by the UAW.

In conclusion, NAPUS is concerned with the thrust of a number of provisions that seek to deny postal employees and retirees statutory health and retirement benefits through the FEHBP and FERS. Nevertheless, NAPUS continues to be willing to discuss the future of postal health benefits, so long as such coverage remains within the FEHBP and the interests of my members are protected. We are troubled by the decision to omit provisions that were included in S. 1789 from the pending bill that helped assure postal accessibility to all Americans. However, we are supportive of those provisions that make the retiree health prefunding schedule more manageable and provide the Postal Service with opportunities for innovation and enhanced pricing flexibility. Indeed, the future of the Postal Service is in our hands and NAPUS wants to work with you as, together, we ensure its viability and relevance.

Postal Reform: An Overview of Budget and Policy Considerations

U.S. Senate
Committee on Homeland Security and Government Affairs

Douglas Holtz-Eakin, President*
American Action Forum

September 26, 2013

*The views expressed here are my own and not those of the American Action Forum. I thank Emily Egan and Chris Holt for their assistance.

Chairman Carper, Ranking Member Coburn, and Members of the Committee thank you for the opportunity to testify today on the topic of postal reform. In this testimony I describe the financial situation facing the United States Postal Service (USPS) and criteria for evaluating comprehensive reform. This testimony seeks to make three key points:

- The financial situation of the USPS is clearly unsustainable;
- Despite a recent slowdown, there is a large risk that health care spending growth will return to previous rates making the USPS funding of their employee and retiree health benefits a sustained burden; and
- Proposals to reform the postal services should be evaluated by (i) the extent to which they alter the fundamentals of future revenue and costs, (ii) the degree to which costs are shifted from USPS to the federal government as a whole, (iii) the degree to which costs are simply shifted across time, and (iv) the degree to which costs are shifted to employees.

Financial Status of the USPS

The USPS is currently in a dire financial situation. Major financial problems include low cash flow, negative profit margins, monies owed to the Retiree Health Benefits Fund, and a statutorily mandated debt limit of $15 billion that USPS reached in 2012. These financial woes are exacerbated by the mandate to prefund the Retiree Health Benefits Fund, which was established by the 2006 Postal Accountability and Enhancement Act. This requirement set a specific amount each year to be deposited into the fund and, as a result, drastically increased operating expenses. The USPS has not been profitable since pre-funding the Retiree Health Benefits Fund was required in 2007.[1] However, as the Congressional Research Service notes, the USPS would have run small deficits in the years 2009-2012 even without the cost of prefunding the Retiree Health Benefits Fund.[2]

As of current estimates, the USPS has $2.7 billion in cash reserves, and while it holds $46.1 billion in the Retiree Health Benefits Fund, it cannot use that money to pay down its debt or withdraw it to use as operating revenue; beginning in 2017 USPS will be able to use the money for retiree health care costs. Currently, the USPS has funded only 50 percent of the future retiree health benefits obligation ($47 billion of the $93.6 billion future obligation).[3]

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[1] http://www.fas.org/sgp/crs/misc/R43162.pdf

[2] *Ibid.*

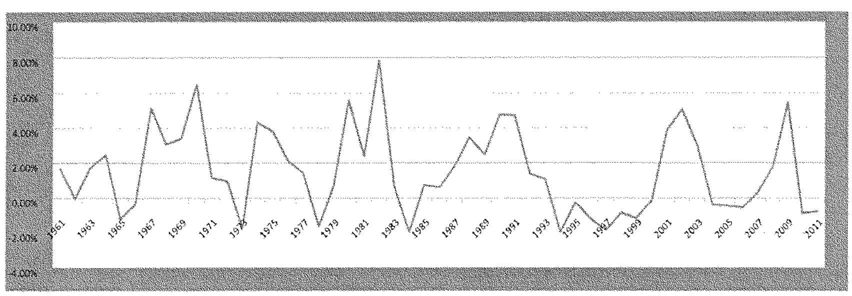
[3] *Ibid.*

Personnel costs are crowding out investment in other areas, such as replacing mail delivery trucks. While the number of employees has been reduced and the USPS has made some strides in efficiency, it remains a labor-intensive business model, with 80 percent of costs composed of compensation and benefits. The recession, the growth of e-mail communication and online bill-pay options, and the prevalence of competitive shipping options such as UPS and FedEx, have led to declining mail and decreased revenue. Clearly the *status quo* is not sustainable.

Health Care Costs

Health care costs have constituted a growing portion of operating costs for the vast majority of employers; large or small, public or private. Accordingly, considerable fanfare has been given to slower growth of National Health Expenditures in recent years. It is difficult to parse out the individual impacts of slow economic growth, health policy and medical practice trends on the growth in spending. For federal programs, the slowdown may also reflect a disproportionate influx of younger Medicare beneficiaries and the expiration of major drug patents. In spite of this, in evaluating USPS reforms it may be prudent to plan for the risk of higher rates of growth in spending. Table 1 below shows that, while national health expenditure growth has been low relative to GDP growth in the past, it has always come back to exceed GDP growth rates.

Table 1: Growth in National Health Expenditures Per Capita Minus GDP Growth Rate, 1961-2011



Source: Calculated from CMS NHE Historical Data & Bureau of Economic Analysis GDP Data

Currently, postal employees receive health coverage through the Federal Employee Health Benefit (FEHB) plans and are eligible for federal retirement programs. When federal employees reach 65 years old and are eligible for Medicare, they sometimes decline the full Medicare benefits available to them, as their retiree health benefits will cover additional benefits like prescription drugs, dental care and vision services.

Health care costs are a large liability now and an even larger liability for the future. The USPS needs to anticipate these future costs. However, the USPS can only raise mail prices in line with inflation - using the Consumer Price Index for urban consumers (CPI-U). By contrast, health care costs grow faster than inflation. As a result, even if mail volume were to stay constant, growth in revenue would not be able to keep pace with health costs. In 2012, per capita health costs for individuals on commercial insurance plans and Medicare grew by 5.8 percent; the CPI-U for 2012 was 1.7 percent.[4,5]

Reform Criteria

Evaluating proposals seeking to ameliorate the USPS's financial trouble should focus first and foremost on the impact on business fundamentals: the scale, scope and pricing of products that will underlie revenue growth and the efficiency, productivity, and compensation of capital and labor that underlie the cost structure.

Alternatively, proposals may simply shift costs from the USPS. For example, it has been argued that USPS "overpays" into the Federal Employee Retiree System because contributions are based on all federal employees, not calculated based on the postal service population. Should USPS begin paying less for their employees, other federal employees and the taxpayer will pay more. Similarly, a proposal to create an exclusively USPS health plan has been introduced, but taking away nearly one-quarter of the FEHB enrollees may cause plans in some areas to leave the market, resulting in increased premiums for other FEHB plans. In both cases, reform merely shifts costs to the overall federal budget.

Secondly, policy makers would be wise to consider the present impact and the future impact of reform. Just as costs can shift from the USPS budget to elsewhere in the federal budget, costs can be shifted to the future, ensuring short-term improvement but not long-term sustainability. For example, dropping the prefunding requirement for the Retiree Health Benefits Fund would help the post office's financial situation in the short and medium term, but with longer life expectancies and the unpredictability of health care costs, the USPS could find itself with a large population of retirees to support and even greater costs

Conclusion

[4] http://www.healthleadersmedia.com/content/HEP-283505/Healthcare-Cost-Growth-Steamrolls-CPI.html##
[5] ftp://ftp.bls.gov/pub/special.requests/cpi/cpiai.txt

The USPS is in crisis and Congress has critical decisions to make about the future of postal services. Performing a critical analysis of the current financial situation, planning for short-term improvements and long-term sustainability, and considering the holistic impact of any reforms will ensure that costs and benefits are weighed appropriately.

"Toward a Financially Viable Postal Service"

Testimony of
Dean Baker, Co-Director
Center for Economic and Policy Research

Before the
U.S. Senate Committee on Homeland Security & Governmental Affairs

Hearing on
Outside the Box: Reforming and Renewing the Postal Service, Part II – Promoting a 21st Century Workforce

September 26, 2013

I want to thank Chairman Carper and Ranking Member Coburn for giving me the opportunity to address the committee. I will use this opportunity to make two key points on the finances of the Postal Service.

1) The rate at which the Postal Service is being required to prefund its retiree health benefits has no obvious economic logic. The current pace of funding poses a serious threat to the Postal Service's survival as an ongoing operation. This excessive burden could create a situation in which the Postal Service is unnecessarily forced into liquidation, leaving taxpayers with the burden of meeting retiree obligations.

2) While many have indicated a desire to have the Postal Service compete with private firms on a level playing field, this is not currently the case. In addition to being required to build up a funding level for its retiree health benefits that has little precedent in the private sector, the Postal Service is also required to invest both its pension fund and its retiree health fund exclusively in government bonds. By contrast, private companies invest their funds in a diversified portfolio. Given the size of the pension and retiree health funds, the difference in returns would translate into several billion dollars a year. This difference would have been sufficient to have eliminated the Postal Service's losses over much of the last decade.

The Rate of Prefunding the Retiree Health Benefit Fund

The point I wish to make on the rate of prefunding set out in the Postal Accountability and Enhancement Act (PAEA) is a simple one. In the PAEA Congress decided to reverse the Postal Service's method for financing retiree health benefits. Until the passage of the PAEA, retiree health benefits were essentially funded on a pay as you go basis, with the funding being treated as a current expense. This is in fact a common practice in the private sector.

While there are good reasons for prefunding retiree health benefits, the pace at which the targeted prefunding level is reached is to a large extent arbitrary. Congress opted to give the

Postal Service 10 years to reach a 73 percent funding target by 2016. This target was expected to require contributions averaging $5.5 billion a year, an amount that is close to 8 percent of the system's current revenue. This would be an extraordinary burden to suddenly place on any company. It is equivalent to imposing a tax of 8 percent on the Postal Service's revenue. There are few businesses that would be able to survive if they were suddenly required to pay an 8 percent tax from which their competitors were exempted.

The goal of ensuring that taxpayers will not be left with the cost of providing health care for the Postal Service's retirees is understandable, but it is not best accomplished by imposing a burden that is large enough to jeopardize the Postal Service's viability. In fact, if this burden unnecessarily forces the liquidation of the Postal Service then the rapid rate of accumulation in the retiree health fund could have the opposite of its intended effect, forcing taxpayers to pick up a large amount of unfunded liabilities.

In this respect, it is important to note that the Postal Service's underlying financial situation has improved substantially in the last two years. The Postal Service was hard hit both by the economic downturn and by technological developments that were leading consumers to rapidly replace first class mail with electronic means of communications. Postal Service revenue peaked at $75 billion in 2008, then fell sharply to $66 billion in 2011. The Postal Service expected revenue to continue to decline rapidly for the rest of decade, falling to $63 billion in 2013 and just $59 billion by 2020.[1] However, this projection proved to be far too pessimistic. The rate of revenue decline slowed sharply in 2012 and has reversed this year, with 2013 revenue running somewhat ahead of the corresponding quarters in 2012.

This pattern is noteworthy because, contrary to what the 2011 projections might have implied, the Postal Service now appears quite capable of being a viable enterprise. It would be showing a profit in the current year if not for its contributions to the Retiree Health Benefit Fund (RHBF).[2] If payments to the RHBF were stretched out over a longer period of time, it could help to ensure the Postal Service's viability and reduce the risk that the taxpayers will be forced to accept this liability.

A delay in reaching the targeted rate of prefunding might seem especially appropriate in the wake of the 2007-2009 recession, which Congress surely did not anticipate at the time it approved the PAEA. While the pace of prefunding required under the PAEA would have been ambitious under any circumstances, it was clearly impossible to sustain in the context of the most severe downturn since the Great Depression. Given the extraordinary depth and duration of the downturn, it would be reasonable for Congress to adjust its prefunding targets to ensure that they do not interfere with the viability of the Postal Service.[3] Given the large level of reserves that the

[1] These figures are taken from Corbett, Joseph. 2011. "The USPS Financial Outlook: December 2011." P 21.
[2] Over the first nine months of 2013 the Postal Service reported a loss of $3,870, which is $330 million less than the $4,200 million it contributed to the RHBF. (UNITED STATES POSTAL REGULATORY COMMISSION, Third Quarter, 2013, Form 10-Q, p24)
[3] It is also worth noting that the Postal Service assumes a much higher rate of health care cost growth than the economy has seen in recent years. The projections of liability assume a 7 percent annual rate of increase in per person health care costs. The most recent projections from Centers for Medicare and Medicaid Services assume cost growth averaging just 5.0 percent for the next decade (Centers for Medicare and Medicaid Services, 2012. "NHE Projections 2012-2022." http://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/NationalHealthExpendData/Downloads/Proj2012.pdf

Postal Service has already accumulated in the RHBF, there is no doubt that it will be able to meet all its obligations even if it is allowed to take a longer period of time to build up to its funding targets.

The Handicaps the Post Service Faces in Competing With Private Companies

For the last four decades the Postal Service has been operating with a mandate under which it was expected to compete with private companies. The expectation has been that the Postal Service would be able to support its operations without the benefit of government subsidies. However, few intended for it to compete with private corporations while facing unique burdens that its private competitors do not share. In fact, this is exactly the situation that the Postal Service now faces, first and foremost because of the requirement that it invest its pension fund and the RHBF exclusively in government bonds rather than a diversified portfolio. (Arguably the Postal Service has been restricted in its ability to enter new lines of business. Given the enormous nationwide delivery system it has in place, this restriction is a considerable handicap.)

The restriction that the Postal Service retiree funds be invested exclusively in government bonds puts the system at major disadvantage compared with its private competitors since it requires the Postal Service to spend much more money to provide the same benefit. One of the Postal Service's competitors, UPS, does in fact offer retiree benefits and is able to do so at a much lower cost than the Postal Service as a result of its freedom to invest in a diverse range of assets. However even if no competitors offered comparable benefits this rule would still put the Postal Service at a disadvantage since it means that it must make payments that private businesses would not be required to make.

Since the Postal Service has prefunded these benefits to such a large extent, this difference in investment returns is a substantial penalty for the Postal Service. The table below shows the returns that the various Postal Service retiree funds would have had in calendar year 2013 under the assumption that they had been invested in a diversified portfolio compared with an assumed 5.0 percent nominal return on government bonds.

Return on Postal Service Retiree Benefit Funds Under Alternative Assumptions (billions of dollars)

	CSRS	**FERS**	**RHBF**	**Total**
Asset level (end of 2012)	191.20	93.50	45.74	
Return from:				
Government bonds at 5 percent	9.56	4.68	2.29	
Diversified portfolio at 7 percent	13.38	6.55	3.20	
Difference (from 5 percent)	*3.82*	*1.87*	*0.91*	*6.60*
Diversified portfolio at 8 percent	15.30	7.48	3.66	
Difference (from 5 percent)	*5.74*	*2.81*	*1.37*	*9.91*

Source: United States Postal Service and author's calculations.[4]

[4] The assets for the various retirement funds can be found in the 2012 Postal Service's Form 10-Q. The pension fund balances are on page 37, and the RHBF on page 42.

As can be seen the difference in returns if the pensions had been invested in a diversified portfolio that earned a 7.0 percent nominal rate of return would have been $6.6 billion in the current year, allowing the Postal Service to enjoy a healthy profit. If the a diversified portfolio had earned an 8.0 percent nominal return, the difference would have come to $9.9 billion in 2013, leading to a very substantial profit for the Postal Service in the current year.

There are reasons that Congress would not want to have the Postal Service invest its retirement funds in a diversified portfolio in the same way as a private corporation, most obviously because it would increase the government's deficit as it is usually reported. However, it must recognize that it is imposing a very costly restriction on the Postal Service. As the table shows, the cost of this restriction is quite large relative to the profits and losses seen by the system in recent years.

Conclusion

In 2006 Congress decided to change the accounting rules under which the Postal Service operated, requiring that it prefund its retiree health benefits rather than treat them largely as a current expense. The legislation required the Postal Service to rapidly build up to it 73 percent targeted level of funding. This funding schedule would have imposed a large burden on the Postal Service under any circumstances; however the burden became unbearable in the context of the worst economic downturn since the Great Depression. Since Congress certainly not anticipate this sort of downturn when it passed the PAEA, it would be reasonable for it to re-examine the timeline for prefunding. There is little obvious risk to taxpayers if the target was stretched out over several decades.

While the Postal Service is ostensibly supposed to be competing on a level playing field with private corporations, it still faces many serious handicaps which its competitors do not share. Most importantly the requirement that it invest its retiree funds exclusively in government bonds makes retiree benefits far more expensive to the Postal Service than to private companies. The difference in returns could be close to $10 billion a year, given current asset levels. This difference is very large relative to the Postal Service's recent profits and losses, implying that Congress is imposing a substantial penalty on the system by this requirement. If it really wants the Postal Service to be a level playing field with private competitors then it should take measures to address this difference in returns.

American Enterprise Institute
for Public Policy Research

Statement before the U.S Senate Committee on Homeland Security and Government Affairs

On

Outside the Box: Reforming and Renewing the Postal Service, Part II – Promoting a 21st Century Workforce

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September 26, 2013

The views expressed in this testimony are those of the author alone and do not necessarily represent those of the American Enterprise Institute.

Dear Chairman Carper, Ranking Member Coburn, and distinguished members of the Committee: thank you for the opportunity to submit written testimony to the U.S. Senate Committee on Homeland Security and Government Affairs on "Reforming and Renewing the Postal Service." I am R. Richard Geddes, Associate Professor in the Department of Policy Analysis and Management at Cornell University, Director of the Cornell Program in Infrastructure Policy, and Visiting Scholar at the American Enterprise Institute.

This statement is a follow-up to my oral and written testimony submitted to the Committee on February 13, 2013 for its hearing on, "Solutions to the Crisis Facing the U.S. Postal Service." The Committee has since then produced a draft bill on postal reform entitled S. 1486, the Postal Reform Act of 2013. This proposed legislation has many appealing aspects. However, there are several issues that could be better addressed.

One of the main concerns is the overall direction in which the S. 1486 legislation takes the Postal Service. By this I mean the degree to which S. 1486 advances the USPS further along the reform course established by the 1970 Postal Reorganization Act, or backs away from that time-tested course.

By creating the modern USPS, the 1970 PRA adopted a more utility-like, commercial model for the Postal Service, in which rates and fees were set to reflect costs (and reduce political influence), wages were established by negotiation between management and employees (rather than set by Congress), and the firm was subject to a break-even constraint (instead of the perennial losses incurred since 1946).

However, the new USPS retained important elements of a government agency. First, USPS remained an independent agency within the executive branch. That is, it was not converted into a "state-owned enterprise" because an enterprise structure with ownership shares – even if held entirely by the government – was not created. Second, USPS retained two government-enforced monopolies (the mailbox monopoly and the delivery monopoly) with attendant monopoly regulation, including controls on market-dominant rates and a prohibition against entry into other markets. In retrospect, there is broad agreement that the 1970 PRA was a necessary, successful reform.

Today, too, there is broad agreement that additional reforms are critically needed to allow the USPS to adapt to the realities of the 21st century's dynamic communications marketplace. The alternative is to condemn the USPS to remain on a fiscally unsustainable path dependent on taxpayer subsidies. In broad terms, the only plausible direction for further reform is, I believe, to continue down the path pioneered by the 1970 act. Indeed, this is the direction taken by virtually all other industrialized countries regarding fundamental postal reform.

To be clear, it is important to distinguish three key postal reform concepts:

- *Commercialization*: This refers to a set of reforms that grants postal managers more flexibility over rates and decisions to enter new markets. Commercialization is typically accompanied by relaxation or elimination of the firm's monopoly privileges (and other special rights), a step which also allows relaxation of regulatory measures established to prevent abuse of monopoly privileges. It also includes more pricing flexibility.

- *Corporatization*: This refers to creating an organizational structure for the firm (which may remain a state-owned enterprise) that is similar to that of a large, publicly traded corporation. Corporatization includes adopting a corporate-style board of directors with explicit fiduciary duties to the shareholder(s), as well as executive pay scales that are less constrained by government regulations. It includes subjecting the Postal Service to the standard laws and norms reflected in modern U.S. corporate law.

- *Privatization*: This refers to the act of actually transferring ownership shares (sometimes called "residual claims") to private owners via a public sale of those shares. This transfer reduces taxpayers' ownership interest in the post.

Other industrialized countries long ago recognized the need for major reforms of their postal sectors. As demonstrated in a report for the European Commission issued this week, 25 of the 27 countries that are members of the European Union have repealed their postal monopolies. The remaining two EU member countries (Cyprus and Romania) will follow suit in the near future, as will the three other countries in the "European Economic Area": Norway, Iceland, and Liechtenstein. All of these countries have allowed their posts to become more commercial and more responsive to market dynamics. All (but Cyprus) have corporatized the post office. Indeed, two countries have fully privatized their post offices (Malta and the Netherlands). In five other countries, the government now owns less than 100 per cent of the post office: Germany (25.5%); Belgium (50%); Austria (52.8%); Romania (75%); Greece (90%). The United Kingdom has recently announced plans to sell a majority of Royal Mail's shares.

While circumstances certainly vary across countries, the broad orientation of sound postal reform has not. Whether one takes guidance from the success of the Postal Reorganization Act in the United States or the more recent reforms in other industrialized countries, the pole star for viable, financially sustainable reform must be moving the USPS further toward a commercialized, businesslike entity. Such a change would fulfill a process begun at least as early as 1970.

From this perspective, I would like to offer several specific comments and suggestions related to the proposed legislation and to U.S. postal reform in general.

1. *Much commentary regarding postal reform discussions has focused on the 2006 PAEA's requirement that USPS make annual prepayments to the Retiree Health Benefit (RHB) Fund of $5.5 billion. However, the USPS's present fiscal crisis is unrelated to that requirement.*

Although the PAEA required the USPS to make a new annual payment of $ 5.5 billion to the Postal Service Retiree Health Benefits Fund for 10 years, it is sometimes forgotten that the Postal Accountability and Enhancement Act (PAEA) also *relieved* USPS of annual payments equal to about $ 5.0 billion. Those reduced payments include the annual escrow payment of $ 3.0 billion and military pension payments equal to about $ 2.0 billion. When PAEA's price cap took effect in December 2007, postage rates were already high enough to cover the escrow and military pension payments, having been considered in the previous rate case before the then-named Postal Rate Commission. Hence, the net effect of the new RHB payments was to create an annual shortfall of about $ 0.5 billion (which USPS should have been able to address through greater efficiencies associated with PAEA).

Since the RHB payments are not the source of USPS's current fiscal problems, relieving USPS of the RHB payments is unlikely to address the main impediments to creating a self-sustaining and efficient Postal Service. Relieving USPS of the RHB payments is equivalent to cash transfers from taxpayers to the USPS, helpful in the short term but of little value for long-run structural reform.

2. *Eliminating the price cap is critically important, but there remains a real risk of excessive pricing for monopoly and market dominant products.*

If the RHB payments are not the main source of the current fiscal crisis, what was? More than anything else, the problem in the PAEA is the statutory price cap on all market dominant products. No other industrialized country has placed the bulk of postal products under a statutory cap. In 2006, the volume of first class mail was falling. This meant unit costs were rising (because it takes *more than* half as many employees to collect and deliver half as much mail). A price freeze in real terms (i.e., 2006 rates plus inflation) was ill-considered in light of a likely continuing decline in mail volume. The recession made matters even worse than could be foreseen at that time.

Eliminating the statutory price cap is a necessary step towards creating a financially viable Postal Service. S. 1486 is commendable in this respect. Judging from the experience of other industrialized countries, Inspector General David Williams's studies are correct — USPS can and should raise prices.

However, giving USPS unlimited pricing freedom creates a foreseeable risk in another dimension. USPS will able to raise rates to create super-normal profits on products for which it has the benefit a legally enforced monopoly (postal or mailbox) or for which there is no effective competition. These "monopoly rents" can be used to cross-subsidize either other market dominant products or competitive products (despite safeguards in the PAEA). Many monopolies (public and private) engage in such behavior. So far, almost all industrialized countries have found it necessary to retain some sort of regulatory control over "abuse of dominant position" by their commercialized post offices even after they have abolished the postal monopoly.

I therefore suggest that the postal monopolies be repealed over a relatively short transition period (say, 3 years). While the postal monopoly it is less and less important economically, repeal will be (as in other countries) an important step towards incentivizing the Postal Service and its employees. In addition, the mailbox should be opened to all carriers meeting basic standards of reliability, administered by the PRC and subject to the householder's right to limit access to the Postal Service only. Raising the delivery costs of private carriers to give the Postal Service an artificial competitive advantage is wasteful and environmentally harmful. It also reduces incentives to develop an innovative, efficient Postal Service. In addition, the PRC should continue to require USPS to keep proper accounts for its market dominant products. PRC should also be able to review market dominant rates according to clearly defined statutory standards (the list of standards in current section 3622 is not "clearly defined"). To the keep PRC on track, the Antitrust Division or FTC might be made a necessary party to any such proceeding.

3. *The obligation to provide public services should be clearly separated from USPS's authority (and mission) to provide efficient and innovative products.*

It is evident that many legislators feel strongly that the Postal Service should continue to provide certain services even though revenues do not fully cover the costs incurred. Examples include maintaining money-losing post offices (especially in rural areas), continuing inefficient network facilities, providing extra days of delivery in areas that receive relatively little mail, and giving non-profit organizations preferential rates. In total, these "extra" or "non-commercial" public services amount to a fairly small portion of the Postal Service's total business. Conflation of the (large) commercially viable portion of the postal business and the (small) public interest portion of postal business is a fundamental obstacle to creating an efficient and self-sustaining Postal Service. Congress exercises authority over the entire postal business in order to ensure provision of a relatively small portion of public services. For its part, the Postal Service justifies special privileges for the entire business as a necessary support for a small portion of services provided as public services.

The solution is decoupling the public service obligation from the authority to manage the commercially viable portion of the business. The Postal Service should have normal, corporate authority to operate the commercially-viable portion of the business, including new nonpostal products. In addition, however, the Postal Service should be obliged to provide public services that Congress determines are required for the public interest. The Postal Service should be compensated for net cost of such public services from public funds. The Postal Service should not be expected to cover the net cost of such public services by raising prices for its commercial customers in an increasingly competitive market.

Even if such a tax were feasible, it is not fair to the Postal Service or its customers. Although many believe that Congress should require the Postal Service to provide public services, it is reasonable that such requirements be disciplined by the need to pay for services rendered (this was a basic premise of the Postal Reorganization Act, but it has been forgotten over time). In effect, "public interest services" should be a viewed as a special product of the Postal Service purchased transparently by government. Again, this is the conclusion that other industrialized countries have reached.

4. *To become efficient and self-sustaining, the Postal Service should be separated from government, not further integrated into government.*

The only way to make the Postal Service self-sustaining, innovative, and efficient is to separate Postal Service management, and their managerial decisions, from government. A self-sustaining, innovative, and efficient Postal Service must respond quickly and strategically to the market, which is changing rapidly. Government necessarily responds to conflicting political demands, usually slowly. Hence, I believe that adding the Secretary of the Treasury to the Board, giving the Board rulemaking-type authority, and plans to give the Postal Service special access to contracts for the provision of government services, are steps in the wrong direction. All move in the opposite direction from the 1970 act and make the USPS more like a government agency.

5. *Standstill provisions should be dropped.*

Provisions of S. 1486 that forbid (1) changes to service standards for first class or periodicals and (2) closure or consolidation of network facilities for 2 years are unduly constraining. They postpone necessary changes for two years and invite vested interests to renew political pressure on Congress in two years. Fundamental postal reform should have been started many years ago. A further two-year delay hardly seems a first step in the right direction.

6. *Reform must allow and incentivize the Board and senior management to operate the Postal Service more efficiently and innovatively, including giving them opportunities to raise additional revenues.*

The Postal Service operates in an environment of rapidly changing *commercial* demands. Ninety percent of all mail is sent by business and organizations, and their needs are evolving with new technologies. To meet the needs of its customers, the Postal Service must have a true Board of Directors with the same expertise and the same fiduciary duty to shareholders (the people of the United States) as the board of any normal corporation. As far as possible, the Board must have the same freedom to attract and compensate managers, to set prices, to restructure existing products and introduce new products, and to negotiate with employees as the boards of the private corporations against whom the Postal Service is necessarily competing to win the business of its commercial customers. The USPS has a valuable commercial asset in a network that allows it to deliver to all U.S. addresses six days per week. It also has a valuable brand name. The key to sustainable postal reform is to give the USPS sufficient commercial freedom to use those assets to generate as much revenue as possible.

This means the Postal Service must be "corporatized," that is, freed from Congressional interference in its daily operations and subject to the same rules and norms as provided by corporate law applicable to typical publicly traded corporations. Conrail provides a successful precedent from another previously ailing industry. Although some postal commentators refer to USPS as a "state-owned enterprise," this is inaccurate. USPS is an independent agency within the federal government like the FCC or SEC.

Corporatization also implies that the Postal Service must face the same incentives for efficiency and innovation as private companies. Special legal privileges like the postal monopoly and mailbox monopoly must be repealed. For the Postal Service – as for any private company – failure to provide a better service than its competitors must have negative consequences. Reestablishing the Postal Service as a typical company would also will give Postal managers clearer authority to manage the business. It will decrease political influence as the USPS becomes more commercially focused. It will simplify the problem of reforming postal employee benefits. It will allow the Postal Service to engage in new businesses. It will tend to create a level playing field for both the Postal Service and private competitors.

7. *Overseas experience suggests that the Postal Service can be self-sustaining even in an electronic marketplace.*

Fortunately, the international experience with postal reform indicates that posts that were formerly government-owned monopolies can, if given the necessary commercial freedoms, be sustainable even in a competitive electronic marketplace. Moreover, in overseas reform, the actual realized net cost of the Universal Service Obligation has proven to be much less than feared if reasonable flexibility is allowed. Despite drastic declines in mail volumes, the U.S. still enjoys a far higher mail volume (and letter volume) per capita than other industrialized countries. Moreover, U.S. letter rates are below those in other industrialized countries, suggesting the possibility of upward pricing flexibility. Although the USPS is now far behind many other posts in becoming more commercialized, the situation is not hopeless if comprehensive legislative reform is adopted promptly.

Postal Workforce – Pay & Benefit Stats

Overall Workforce Stats:

The Postal Service's workforce currently totals, 490,000 - down from a high of 797,795 in 1999 and down nearly 26 percent in the past five years.

Wages and benefits comprise 80 percent of the Postal Service's costs.

USPS - Average Postal Pay & Benefits:

The FY 2012 average pay & benefits (minus retiree health care costs) for career craft employees is as follows:

CAREER BARGAINING UNIT EMPLOYEES

FY 2012 AVERAGE COMPENSATION (Includes Overtime)

	SALARY	BENEFITS	TOTAL
TOT BARGAINING UNIT	$47,300	$28,950	$76,250
CITY CARRIERS (NALC)	$50,550	$28,750	$79,300
MAIL HANDLERS (NPMHU)	$46,100	$30,500	$76,600

- Retiree health care costs would add roughly $5,156.51 per employee.[1]

[1] USPS had 528,458 career employees at the end of the year and accrued $2.725 billion in normal cost liability for retiree health care.

Federal (generally) vs. Private vs. State/Local - USA Today Analysis of Bureau of Economic Analysis Data (2009)

	Federal Civilian	State/Local Government	Private
Salary	81,258	53,056	50,462
Benefits	41,791	16,857	10,589
Total Compensation	123,049	69,913	61,051
Hourly Compensation (Assuming 2080 hours)	$59.15	$33.61	$29.35
Percentage More than the Private Sector	101%	14.5%	

People Clamoring for Positions:

Postal openings are highly sought after. In a normal marketplace, this would provide an incentive to keep labor costs down.

For example, new City Carrier Assistant (CCA) positions were initially posted and open for application from January 23 – January 27, 2013.

The average daily CCA applications totaled 19,000 for all postings across the country. The total applicant pool was over 95,000 over the 5 day period. Ultimately, more than 170,000 people applied for the roughly 32,000 positions.

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TESTIMONY

of

Jon Adler
National President,
Federal Law Enforcement Officers Association

on

"Outside the Box: Reforming and Renewing the Postal Service, Part II: Promoting a 21st Century Workforce"

Before the

Senate Committee on Homeland Security & Governmental Affairs

September 26, 2013

Mr. Chairman, Ranking Member Coburn, and Members of the Committee:

Thank you for the opportunity to submit testimony for this important hearing on behalf of the membership of the Federal Law Enforcement Officers Association (FLEOA). FLEOA is the largest nonpartisan, nonprofit professional association exclusively representing more than 26,000 active and retired federal law enforcement officers from over 65 different agencies.

FLEOA is submitting this testimony because of our serious concerns with the form and manner with which this Committee is attempting to use legislation designed to salvage the U.S. Postal Service as a means to enact government-wide reforms of the Federal Employees Compensation Act (FECA). In the context of this legislation, the government-wide revisions to FECA contained in Title V of the "Postal Reform Act" is an ancillary issue. We do not believe that this is the proper vehicle to address the myriad issues with the FECA system, and urge the removal of Title V from the legislation in its entirety.

Every year, hundreds of federal law enforcement officers sustain line of duty injuries in performance of their duties at home and abroad. These injuries are the result of such things as violent physical encounters, vehicle accidents, training incidents, exposure to hazardous materials, and drug enforcement operations. Consider the following:

- Special Agent Mike Vaiani was at Ground Zero on September 11, 2001. Before the second tower collapsed, Vaiani and a firefighter ran into the building and rescued injured firefighters and civilians. In the process, Vaiani sustained serious injuries to his neck, shoulders, and back. Today, Vaiani continues to endure severe upper body pain with steel plates in his neck and back. Vaiani is currently receiving FECA benefits.
- More recently, Deputy U.S. Marshal Jason Matthew was stabbed by a female inmate who had secreted an HIV-contaminated edged weapon on her person. After Matthew subdued the inmate and successfully escaped the lethal attack he was taken for emergency medical care. While at the hospital, Matthew learned that the inmate tested positive for HIV and was immediately given medication to combat the HIV exposure. He continues to be monitored for HIV infection.
- Finally, former Navy SEAL and Federal Air Marshal Donald Tyson had a career that took him to most continents and several hotbeds of violence around the globe. As a result of his commitment to protect and serve, Tyson is now permanently disabled after contracting a degenerative heart disease during his service as an Air Marshal. He has sacrificed both his heart and his overall wellness, survived several open heart surgeries, and lives with a disability that has limited his movements and quality of life. Tyson is currently receiving FECA benefits.

These and countless other federal law enforcement officers answered the call of duty when and where it arose, and they suffered disabling injuries in the performance of that duty. In one case, a member of the FBI's elite Hostage Rescue Team was severely injured in a grenade attack in Afghanistan. Other law enforcement officers are injured protecting the President of the United States or other dignitaries. Some are hurt while interdicting narcotics destined for our schools or communities. Still others are injured attempting to bring dangerous wanted fugitives to justice. Regardless of the circumstances of their injury, these federal law enforcement officers are heroes. That is an important fact that cannot and should not be overlooked—particularly in the context of legislation that will reduce FECA benefits for disabled federal law enforcement officers to 50 percent of pre-disability wages once they reach retirement age.

Concerns with S. 1486, the "Postal Reform Act of 2013"

The revisions to the Federal Employees Compensation Act are contained in Title V of S. 1486, the "Postal Reform Act of 2013." The main purpose of this Title is to attempt to move a disabled federal employee off of the FECA rolls and into the federal retirement system once the employee reaches normal retirement age (as defined by the Social Security Administration). This is accomplished principally through a reduction in the level of FECA benefits that they are eligible to receive. This proposal raises a number of questions. Primarily because it does nothing to address the unique nature of law enforcement work, law enforcement disabling injuries, and the unique needs of disabled federal law enforcement officers. Instead, Title V advances a "one size fits all" approach to FECA reform that leaves many issues unresolved.

One question this proposal raises, for example, is how the retroactive reduction of benefits for current FECA enrollees at retirement age will affect federal law enforcement officers. Under current retirement law, federal law enforcement officers are eligible to retire at age 50 after 20 years of service, at any age after 25 years of service, and must retire when they reach age 57. Because of the earlier retirement eligibility, law enforcement officers pay more into their retirement system than regular federal employees. While the individual is on the FECA rolls, however, they generally do not earn service credit towards their retirement unless they are eligible to first return to work. Nor can they accrue additional Social Security benefits or contribute to their TSP. For officers who face benefit reductions and would like to take retirement to avoid financial hardship, what type of retirement are they eligible to receive? Will it be regular FERS/CSRS retirement or the enhanced law enforcement retirement? If placed into regular retirement open to all federal employees, do they receive a refund of the excess contributions they've made into the system? What if they are incapable of returning to work and must remain on FECA until they reach retirement age?

Second, if a disabled officer is forced into retirement, who pays for any ongoing medical expenses associated with the disabling injury? It would seem logical that for a law enforcement officer who was disabled after being shot in the process of serving a warrant or exposed to toxins while taking down a meth lab the federal government should continue to pay for any ongoing medical expenses that are directly related to the disabling injury. While an individual is on FECA, that is not an issue. However, an individual who is forced into either regular retirement or disability retirement would need to enroll in FEHBP retiree health benefits. He or she would thus be responsible for paying annual premiums, copays, etc., for *all* medical care he or she receives.

Finally, how do you calculate a fair disability retirement pay for an injured Federal law enforcement officer? Law enforcement officers who are forced into a disability retirement usually sustain injuries that are markedly different than those sustained by general federal employees. Indeed, the phrase "line of duty injury" means one thing for a law enforcement officer, and something very different for a GS-301 Administrative Employee. A Special Agent wakes up each day knowing that there is a real risk that he may be critically injured or killed on the job. And the disability retirement system should reflect that reality of federal law enforcement work. However, given that (as noted above) a disabled law enforcement officer will not have reached the service requirements necessary to be eligible for the enhanced law enforcement retirement benefit, left unanswered is the question of how the federal government can or will calculate a fair disability retirement pay for disabled law enforcement officers.

Because Title V does not address basic questions like those above, FLEOA requests that it be removed from the bill in its entirety. Congress can and should consider reforms to the Federal Employees Compensation Act. When it does so, it should take the time to examine both the current FECA system as well as problems with the disability retirement system government-wide. But such discussions have not occurred because revisions to FECA are a small part of this narrower bill designed principally to reform the U.S Postal Service.

FLEOA Recommended Reforms In Lieu of Title V

Over the course of the past several years, FLEOA has supported meaningful reforms of the Federal Employees Compensation Act on both the legislative and administrative levels. Our work with the Department of Labor, for example, led to the establishment of traumatic care nurses for law enforcement injuries and a law enforcement Ombudsman in each OWCP district. We have also worked with Members and staff of this Committee and the House of Representatives on legislation to strengthen FECA. Unfortunately, however, the existing system with all of its flaws is still better suited to the needs of disabled federal law enforcement officers than the revamped system included in S. 1486.

In the areas of pay, retirement benefits, relocation and transfer, and physical standards, federal law enforcement officers are treated differently than their civilian counterparts. This is due to the unique operational requirements of law enforcement agencies. FLEOA believes that federal law enforcement officers should also be treated differently when they are injured in the line of duty. Specifically, FLEOA believes that FECA reform should achieve the following goals:

1. *Ensure that any changes to the Federal Employees Compensation Act are prospective only.* As currently contemplated, the changes proposed in S. 1486 would apply to existing FECA recipients except where certain exceptions would apply such as the age of the disabled employee or nature of the injury as of the date of enactment. There are a large number of employees, however, who would not be so fortunate. These individuals would face a reduction in benefits to 50 percent of their pre-disability wages. There is no justifiable public policy rationale that is served by pulling the standard of living rug out from under a disabled federal law enforcement officer at a time when they are least able to afford it. These individuals were hired and injured under one federal workers compensation system, and it is patently unfair to change the rules on these employees after they have sustained a disabling injury.

2. *FECA reform should strengthen anti-fraud and program integrity capabilities, especially within the Office of Inspector General.* By and large, the call for FECA reform is led by those who argue that DOL must strengthen program integrity and fight fraud. One option for accomplishing this goal is to assign a DOL-Office of Inspector General (DOL-OIG) agent to be a liaison with OWCP and make such individual responsible for fraud investigations in every region. Additional OWCP liaisons should also be established with every federal agency under its umbrella, and that liaison should monitor its own agency's disability payouts. Second, the DOL-OIG should be granted full access to OWCP systems and an analyst should be assigned to review data for potential fraudulent activity (such as for doctors and physical therapy offices with excessive billings, or individual employees that return to work and then file for recurrence). Finally, OWCP should have a more formal information sharing arrangement with both the Social Security

Administration and U.S. Department of Agriculture so that OWCP can cross-check disability and food stamp payouts, as well as the DOL unemployment insurance database.

3. *Federal law enforcement officers should be removed from the Division of Federal Employees Compensation, and a fifth division established under OWCP to exclusively handle federal law enforcement claims.* Currently, federal law enforcement officers suffer severe financial hardship while their cases are being evaluated, often placing them in jeopardy of losing their homes and forcing them to turn to family and friends for their economic survival. The current system simply does not take into account the fact that most federal law enforcement officers' claims are more serious than those sustained by their civilian counterparts. In many cases, officers are so badly injured that they themselves are incapable of making the application and loved ones, many of whom have no experience with federal employee issues, fill out the paperwork. Aggregating all law enforcement claims in one area will allow OWCP to not only focus its resources, but also provide greater accountability, transparency, and expertise in the handling of law enforcement cases.

4. *Allow federal law enforcement officers to stay with their agency in a continuation of pay (COP) status for up to one year.* Currently, officers can remain in continuation of pay status for 45 days. For those officer's assaulted by a suspect, exposed to a toxic substance, or injured by a firearm or explosive, a one-year time frame would allow a proper period of evaluation necessary to determine if a return to work will be possible. In addition, one of the most common complaints from injured officers is that OWCP does a poor job processing pay. Anecdotally, we know that in many cases the pay is incorrectly calculated and repeatedly delivered late. Allowing law enforcement officers to remain on their agencies' payrolls will remove them from this morass and will also have two other key benefits.

   First, it will get officers back to work quicker. Injured officers enrolled in OWCP are detached from their agency and often feel isolated. Law enforcement is not just a job, it is a way of life. This change will allow many officers to come back to work earlier in a light duty/restricted duty status and allow the agency to derive a benefit from their experience and training during their continued employment. Second, it allows officers to continue to accrue time toward retirement. Unlike most federal employees, officers face mandatory retirement at age 57. A serious injury, and being placed on FECA, effectively prevents them from accruing time toward retirement, and from contributing to the Thrift Savings Plan. Most federal employees can make an adjustment from an injury by working longer. This is not an option for officers and the time lost cannot be regained.

5. *Ensure continuation of medical care for compensated/compensable injuries for those individuals who elect to retire.* In many cases, an injury to a law enforcement officer may be so severe as to prevent them from ever returning to work. Many of these officers will chose to retire under regular FERS/CSRS instead of accepting a disability retirement. At a minimum, any changes to FECA should ensure that a disabled federal law enforcement officer continues to receive FECA-like health insurance benefits for a line of duty injury even after retirement. This would guarantee that an officer would not have to pay out of pocket under their retiree FEHB benefits for ongoing medical treatment and services for a line of duty injury.

6. *Allow law enforcement officers who have not attained age 50 or 20 years of service to retire at the higher law enforcement officer rate under 5 USC 8336(c) or 8412(d) ("LEO Retirement").* Federal law enforcement officers are eligible for regular retirement with 20 years of service at age 50, or after 25 years of service at any age. This—along with the requirement of mandatory separation at age 57—ensures that the ranks of federal law enforcement agencies are staffed with individuals who are physically capable of meeting the rigors of the job. It also requires federal law enforcement officers to contribute towards their retirement at a higher rate than other federal employees. Under current law, however, a law enforcement officer is not eligible for this "early" retirement unless they have met both the age and service requirements. An officer who suffers a disabling injury in the line of duty that prevents them from completing their service requirements does not have the option of taking LEO Retirement, but must elect to either stay on the FECA rolls, take disability retirement, or retire with the standard FERS/CSRS benefit. Allowing disabled law enforcement officers to retire at the LEO Retirement rate would increase the number of officers who take this option.

Conclusion

In these comments, we have attempted to outline for the Committee just a few of our concerns with Title V and provide alternatives for meaningful reform of the FECA system. We have done so in an effort to illustrate that revising FECA is no small task, and there are no easy answers. We believe that the careful balance which must be struck between protecting taxpayer funds and caring for disabled federal employees simply cannot be done within the context of a larger postal reform measure. In resolving the challenges that confront the U.S. Postal Service, government-wide reform of FECA is an ancillary issue. We believe that there needs to be a focus solely on FECA by both the House and the Senate; one that looks at the benefit structure, but also considered in the context of the disability retirement system.

In the end, Mr. Chairman, our federal law enforcement officers are a highly motivated and highly trained group of professionals who are held to a higher standard than any other federal employees. They routinely place themselves in harm's way for the protection of society and for the defense of their country. If federal law enforcement officers are to continue facing the daily dangers that their occupation brings, they need to do so with the knowledge that they will be taken care of in the event of a disabling injury.

We appreciate the opportunity to provide this testimony to the Committee. FLEOA stands ready to work with you and other Members on this important issue.

TESTIMONY FOR THE RECORD BY
JOSEPH A. BEAUDOIN
PRESIDENT
NATIONAL ACTIVE AND RETIRED FEDERAL EMPLOYEES ASSOCIATION

BEFORE
THE SENATE HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS COMMITTEE

HEARING TITLED

"OUTSIDE THE BOX: REFORMING AND RENEWING THE POSTAL SERVICE, PART II - PROMOTING A 21ST CENTURY WORKFORCE"

SEPTEMBER 26, 2013

Chairman Carper, Ranking Member Coburn, and Members of the Senate Homeland Security and Governmental Affairs Committee:

On behalf of the five million federal and postal workers and annuitants represented by the National Active and Retired Federal Employees Association (NARFE), I appreciate the opportunity to express our views regarding postal reform proposals, notably the Postal Reform Act of 2013, S. 1486.

NARFE strongly opposes S. 1486 due to its radical changes to long-standing employee and retiree benefits programs for hundreds of thousands of current, future, and former postal workers, as well as millions of other federal workers and retirees. NARFE objects to the bill for the following reasons, each of which is sufficient to justify opposition to the bill as a whole.

(1) Sections 104 and 105 of the bill threaten to undermine the affordability and quality of health care for federal and postal employees and retirees.

(2) Sections 502 and 503 of the bill would substantially reduce insurance compensation for federal and postal employees disabled by a work-caused injury or illness.

(3) Section 102 of the bill would eliminate the guarantee of the entire defined-benefit pensions for newly-hired postal employees.

NARFE also opposes reducing service standards for the long-standing, basic government service provided by the United States Postal Service (USPS).

Threatening Affordable, Quality Health Insurance for Federal and Postal Employees and Retirees

<u>NARFE opposes section 104 of S. 1486</u>

Section 104 allows for, and essentially makes inevitable, the creation of a separate postal employees health benefits plan. Unlike the provision contained in last year's Senate-passed postal reform bill, S. 1789 (112^{th} Congress), section 104(b)(4) would make negotiations over a separate health benefits plan a mandatory subject of bargaining, subject to arbitration, rather than a permissive subject of bargaining. This would all but ensure the creation of a separate postal plan. While section 104 allows the new plan to be offered as a plan within the Federal Employees Health Benefits Program (FEHBP), it may be offered outside of that program. NARFE is strongly opposed to such a proposal.

First, FEHBP coverage in retirement is contingent upon coverage while employed. By creating a health plan that is not "offered under chapter 89 of title 5 of the United States Code," postal employees covered by that plan would be losing the guarantee of FEHBP coverage in retirement, depriving them of a benefit they have earned from a career of work. Individuals with mixed work histories, having worked for both the federal government and the USPS, would be punished for having retired from the postal service. While section 104 does not mandate providing health care coverage outside of FEHBP, it does authorize it.

Second, putting aside savings that could be achieved by depriving retirees FEHBP coverage, which should not be done, the proposal is likely to cost, not save, money for the government, while simultaneously undermining FEHBP as a whole. It threatens to divide, and therefore undermine the risk-sharing strength of, the FEHBP risk pool, now 8.2 million participants strong, while duplicating administrative costs. Section 104 specifically requires health care coverage that is actuarially equivalent to coverage provided under FEHBP, so it's unclear how the postal service would save money by reducing benefits – itself a bad idea. Finally, to the extent that using the leverage of the entire Postal Service workforce to negotiate cheaper premiums could save some money, such an approach runs counter to the success of the FEHBP model, which relies on plan competition for participants to ensure adequate consumer choice among plans and to reward innovation and satisfactory service.

NARFE opposes section 105

Section 105 of the bill would establish additional, but separate, enrollment options within FEHBP for postal employees, retirees, and their family members, who are enrolled in Medicare Parts A and B. It would create a separate risk pool for these individuals, allowing for lower premiums due to the lower cost of providing supplemental health care coverage when Medicare is the primary payer.

The provision is essentially the same as a provision included in the Manager's Amendment to last year's Senate postal bill, S. 1789. Prior to floor deliberation, the Office of Personnel Management (OPM) released data analysis indicating that the effect of the provision would be an increase in premiums for existing FEHBP plans across-the-board by at least 2 percent on average, and by as much as 35 percent for some plans. Due to this analysis, the Senate removed the provision from the bill by voice vote. It should be rejected again.

By taking Medicare-enrolled employees and retirees out of the FEHBP risk pool, but leaving in the seniors who are eligible for, but not enrolled in, Medicare, the provision removes a group of individuals that are cheaper to cover, while leaving in a group of individuals that are the most expensive to insure. And while section 105 allows for waiver of late enrollment penalties for Medicare, it does not allow for automatic enrollment in Part A (a no cost benefit to the individual), which minimizes the cost savings to FEHBP from Medicare enrollment.

Furthermore, if combined with section 104, the impact on the remaining FEHBP participants is even greater. While the population of employees removed by section 104 would not differ substantially in terms of average cost of coverage, according to previous assertions by OPM, it would increase the percentage of the highest cost, non-Medicare-enrolled participants in the remaining FEHBP population, raising premiums for all FEHBP participants.

USPS proposal

Since August 2011, USPS has claimed it could achieve massive cost savings through the creation of a separate USPS-administered health benefits plan for postal employees and retirees. It is important to understand where those savings come from, and how sections 104 and 105 differ from the USPS proposal.

According to a July 2013 report by the Government Accountability Office (GAO), GAO-13-658,[1] USPS would realize financial gains from its plan "primarily by increasing retirees' use of Medicare." Medicare is the primary payer for retirees, whether in FEHBP or the private-sector. Thus, increasing Medicare enrollment for postal retirees would reduce the average cost of coverage, as FEHBP plans would only be providing supplemental coverage. According to USPS, about 10 percent of postal retirees are not currently enrolled in Medicare Part A (hospitalization coverage), despite the fact that coverage is free, and they have paid taxes throughout their working lives to fund it. This is likely due to the fact that employment covered by the older Civil Service Retirement System (CSRS) did not provide qualifying work credits for Social Security, and most individuals are automatically enrolled in Part A (and Part B) through Social Security. Also, about 24 percent of postal retirees are not enrolled in Medicare Part B. Because Part B coverage requires additional premiums, some federal and postal retirees opt not to pay more for often duplicative coverage. Finally, very few federal and postal retirees opt to receive Medicare Part D, as FEHBP provides adequate prescription drug coverage. However, USPS would seek to receive a Medicare subsidy by participating in a Medicare Part D Employer Group Waiver Plan. USPS estimates greater utilization of Medicare would reduce its future retiree health care liability by about $48.8 billion, close to its $50.9 billion unfunded liability for future retiree health care obligations.

In this respect, NARFE is not opposed to increasing utilization of Medicare for both federal and postal retirees. But, first, as mentioned above, splitting off postal employees and retirees from FEHBP would have a significant adverse impact for the remaining FEHBP participants. Second, policies aimed at increasing Medicare utilization do not require creating a postal health benefits plan separate from FEHBP – they can be implemented within it. Keeping these reforms within the existing program would avoid the disruption that would result from separating 25 percent of participants from the plan, and would keep intact the widely-celebrated model of cost control and consumer choice represented by FEHBP.

On March, 27, 2012, Walton Francis, a neutral, nonpartisan expert on FEHBP and health insurance, testified before the House Oversight and Government Reform Committee on the USPS proposal. While NARFE is not endorsing all of the arguments he made in his testimony, it should be required reading material for anyone seriously considering supporting a USPS-administered plan. Notably, take heed of his assessment that "[t]he USPS proposals would massively disrupt or destroy the FEHBP, the single most successful health insurance program ever operated by the United States government. In destroying the FEHBP, the USPS would disrupt the health insurance of 8 million Americans, and breach statutory entitlement promises made to millions of Federal retirees."[2]

Of course, sections 104 and 105 are not the legislative representation of the USPS proposal. First, section 105 does not automatically enroll retirees in Medicare Parts A and Part B. While it would allow for voluntary enrollment with a waiver of late enrollment penalties, a policy

[1] U.S. Government Accountability Office, *U.S Postal Service, Proposed Health Plan Could Improve Financial Condition, but Impact on Medicare and Other Issues Should Be Weighed before Approval*, (GAO-13-658), available at: http://www.gao.gov/assets/660/656011.pdf.

[2] Testimony of Walton Francis. U.S. Congress. Hearing of the House Oversight and Government Reform Committee, titled "Can a USPS-Run Health Plan Solve Its Financial Crisis?" (March 27, 2012). Available at: http://oversight.house.gov/wp-content/uploads/2012/03/3-27-12-USPS-Francis.pdf.

NARFE supports, it is not likely to increase utilization of Medicare to the extent of the USPS proposal, and thus provide USPS significantly less savings. However, this would prevent forcing many postal retirees to pay additional premiums for Medicare Part B coverage that is mostly duplicative of their current coverage – a good thing. Second, section 104 does not require creating a plan outside of FEHBP, which could prevent disrupting the system and depriving future retirees of FEHBP coverage. However, without altering retiree health benefits, USPS would not be able to take advantage of the cost savings from increased Medicare utilization, which is the driving force behind its proposal. That makes one think that the option to create a plan outside of FEHBP, rather than within it, is the intent behind section 104. NARFE will remain strongly opposed to such an option.

Substantial Reductions to Workers' Compensation

NARFE opposes unjustified and unfair proposals to reduce workers' compensation benefits for federal and postal employees disabled by a job-related injury or illness, notably included in Title V of S. 1486. Senators should re-examine their views regarding these provisions, which were included in S. 1789 (112th Congress), in light of the analysis released last November by the Government Accountability Office.[3]

Specifically, NARFE opposes the provisions of Title V that: (i) would reduce the basic federal workers' compensation benefit by 25-33 percent for workers at or above retirement age, i.e. section 502; and (ii) would eliminate the supplemental benefit for injured workers with children or other dependents, i.e. section 503.

The Federal Employees' Compensation Act (FECA) provides basic compensation to federal and postal employees disabled by work-related injuries and illnesses. For example, FECA provides insurance compensation to an FBI agent shot on the job. In exchange for their reasonable benefits, FECA recipients lose their right to sue the government for their work-caused impairment. While compensation is modest, it will never be able to reverse the permanent damage from a debilitating injury or illness.

If the FECA provisions of S. 1486 were to become law, injured employees would not be afforded the level of income security they deserve and would have earned had they been able to continue working. According to the GAO report, federal workers disabled as part of their service would receive up to 35 percent less in retirement age income than if they were not injured and retired after 30 years under FERS. Under current law, median FECA benefits for totally disabled workers are "on par with or less than" what they would have received after a full 30-year career. Additionally, S. 1486 would eliminate the 8.33 percent supplemental benefit for injured workers with dependents, even as the GAO report shows that the median after-tax replacement rate of income is only 81.6 percent under current law. Finally, GAO found that these policy changes would have a disproportionate impact on the lowest-wage employees and those who are injured early in their careers.

NARFE does not oppose all FECA reforms – in fact, we have continually supported a bipartisan House bill, H.R. 2465 (112th Congress), the Federal Workers' Compensation Modernization and

[3] U.S. Government Accountability Office, *Federal Employee's Compensation Act, Analysis of Proposed Program Changes*. (GAO-13-108), available at http://www.gao.gov/assets/650/649716.pdf.

Improvement Act of 2011, which passed the House by voice vote on November 29, 2011. The bill provides common-sense reform that achieves cost savings for taxpayers by improving program integrity and reducing costs while improving fairness towards disabled workers. It, not S. 1486, should provide the model for reform.

Eliminating Guaranteed Retirement Benefits for New Employees

As if the above provisions, along with numerous job-depleting proposals in the bill, notably reducing mail delivery to five days and eliminating to-the-door delivery, did not ask the postal workers to sacrifice enough, section 102 eliminates the promise of retirement income security for the next generation of postal employees. It allows the Postal Service to bargain with the postal unions to eliminate the FERS defined benefit annuity for new employees, taking away the guarantee of a major element of their retirement package. Simply put, this is an awful provision that starts a very slippery slope for the rest of the federal workforce.

Section 102 would be especially harmful to the many veterans that will be employed by the postal service; currently, over 108,000 veterans, or over 20 percent of the workforce, are career postal employees. Because veterans are able to provide a deposit to credit their military service years towards their federal service under FERS, they would be deprived of the retirement income derived from both their military service and postal career.

Reduced Service Standards

NARFE supports preserving current service standards for the Postal Service, including maintaining six-day delivery, to-the-door or curbside delivery where in place, and keeping post offices open based on customer service standards rather than profitability. The Postal Service provides a basic government service that has existed since the 18th century; it is not meant to be a for-profit business enterprise.

Unfortunately, S. 1486 removes the protections necessary to keep in place current service standards. Section 204 would allow for an end to six-day delivery. Section 205 allows for a transition away from to-the-door or curbside delivery, moving to cluster box delivery. This is of particular concern to NARFE members, as most of them are retired and some may not have the ability to walk several blocks to retrieve their mail, and they shouldn't have to. While the section provides an exception for physical hardship, it requires affirmative application, and the exception is too limited by its definition, which requires that no other form of mail delivery be available.

Conclusion

S. 1486 would make radical changes to long-standing employee and retiree benefits programs for hundreds of thousands of current, future, and former postal workers, as well as millions of other federal workers and retirees. Without substantial changes, notably the removal or substantial alteration of sections 102, 104, 105, 502, and 503, no member of Congress should support the bill.

Thank you for the opportunity to share our views with you.

NTEU
The National Treasury Employees Union

Statement of Colleen M. Kelley

National President

National Treasury Employees Union

on

S. 1486, Postal Service Reform Legislation

Submitted to

Senate Homeland Security and Governmental Affairs Committee

September 26, 2013

1750 H Street, N.W. • Washington, D.C. 20006 • (202) 572-5500

Chairman Carper, Ranking Member Coburn, Members of the Committee, on behalf of the 150,000 federal employees and retirees represented by the National Treasury Employees Union, I appreciate this opportunity to provide testimony on S.1486, the Postal Reform Act of 2013.

For 2014, OPM has just announced that premiums for health insurance plans under the Federal Employees Health Benefits Program (FEHBP) will increase an average of 3.7%. In 2013, premiums increased an average of 3.4%, following an increase of 3.5% in 2012. These are average increases -- some plans' premiums increased by substantially larger amounts. During this same time period, and continuing through today, federal pay has been frozen. Federal employees have gone three years without a pay increase. In addition, many of the employees represented by NTEU have been subjected to numerous unpaid furlough days this year. Despite federal employees' contributions to reducing the deficit -- which to date exceed $114 billion dollars, the legislation before this Committee today seeks to shift additional costs on to the federal workforce. This time, federal employees are being called on to pay extra for their health benefits in an effort to bail out the Postal Service.

The Postal Service claims that it can operate its own health insurance plan more efficiently and at less cost than the FEHBP. There is no evidence to support this conclusion and in fact, the opposite may well be true. Typically, the annual increase in FEHB premiums is lower than the increases experienced by large private sector employer plans. Any savings the Postal Service would likely reap would come not from shrinking costs, but rather from shifting costs onto employees and retirees by requiring them to pay higher premiums for their coverage, by reducing their benefit packages and/or by increasing employee and retiree copayments and deductibles. S.1486 has the potential to disrupt the health insurance benefits of 8 million federal employees, retirees and their dependents and NTEU cannot support the legislation in its current form.

Section 104 of S.1486 sets in motion the adoption of a separate Postal Service employee health benefit program. It would mandate negotiations between the Postal unions and the Postal Service over a separate health benefits plan and subject the process to arbitration if/when negotiations did not bear fruit. Postal employees forced into a new Postal-only plan would no longer be part of the FEHBP and therefore would be stripped of their ability to carry FEHBP coverage into retirement. Under the legislation, it seems this would apply even to employees who worked most of their careers in federal executive branch agencies and earned the right to carry FEHB coverage into retirement long before working for the Postal Service. Moreover, instead of the 230 plan choices currently offered in the FEHBP, Postal employees could be left with one health benefit choice under this scenario.

This same provision threatens the stability of the FEHB by potentially stripping the FEHBP of active Postal employees and Medicare-eligible Postal retirees. Only the most expensive Postal retirees would remain in the FEHB -- those without Medicare coverage under Parts A and B. It is not even clear under the legislation whether the family members of Postal employees and retirees would be eligible for health insurance coverage through either the FEHBP or a new Postal-only plan.

In its July 2013 report on the Postal Service's health benefits proposal, the Government Accountability Office (GAO) found that the Postal Service's withdrawal from the FEHBP would reduce the FEHBP program's enrollment by 25% and could lead those plans with primarily Postal enrollment to withdraw from the program. This would have the unintended effect of forcing over 3 million non-Postal enrollees to choose a new health plan and possibly new service providers as well. In addition, because the Postal Service would be permitted to invest its health plan assets in stocks and other assets outside of Treasury securities, losses in a market downturn could mean that the Postal Service would have reduced assets available to fund health care benefits for its employees and could jeopardize their ability to provide those benefits to their employees and retirees in the future.

Section 105 of S.1486 would establish Medicare wrap-around plans for Postal employees and retirees who are enrolled in Medicare Parts A and B. Because these are the least expensive individuals to insure under the FEHBP, removing them from the overall FEHBP risk pool would inevitably lead to increases in premiums for those remaining in the FEHBP. The Office of Personnel Management has in the past estimated that as a result of this provision alone, premium increases for employees and retirees would be two percent across the board and could be as high as 35% for some plans.

Section 105 also allows for a waiver of late enrollment penalties for those Postal retirees who failed to enroll in Medicare when first eligible. Shifting costs to Medicare to stabilize the Postal Service does not seem to be the best answer. If Postal retirees who declined Medicare Part B enrollment at eligibility are relieved of late enrollment penalties, at a minimum, other federal employees who must pay these penalties each month and those who have not signed up for Medicare Part B because of the penalties should also be given this opportunity.

Federal and postal employees show up for work each day expecting to perform their duties diligently and professionally in service to their country and then safely return home to their families. Nevertheless, some will suffer workplace injuries that make it impossible for them to return to work for short or long periods of time and, regrettably, in some cases to never be able to return to work at all due to permanent injury or even death.

Workers' Compensation insurance is a recognition of the responsibility of employers and society to take care of those who are injured in the workplace. It was our nation's first social insurance program. Today, Workers' Compensation stands as an important protection for the benefit of all Americans. Almost 98% of the workforce is covered by workers' compensation insurance. The Federal Employees' Compensation Act (FECA) provides federal employees with workers' compensation coverage for injuries and diseases sustained while performing their duties. The program seeks to provide adequate benefits to injured federal workers while at the same time limiting the government's liability strictly to workers compensation payments.

NTEU would support a review of the FECA program and has in fact worked with both Republican and Democratic administrations in the past toward this goal. However, I want to state our strong opposition to insurance benefit cuts, particularly for those employees who came to work one day ready to serve their country but suffered a workplace injury that resulted in them never being able to return to work. We are strongly opposed to the provisions in S.1486 that would cut benefits for older, injured beneficiaries and for those injured workers with family obligations.

An employee who is injured on the job and unable to work receives FECA payments equal to only 67% of wages at the time of injury (75% if he has family obligations). This reduction in income makes it impossible for an injured employee to fund a retirement plan. Once workplace injured workers are on FECA, they receive no further step/grade increases or retirement contribution matches, nor are they able to make elective contributions to the Thrift Savings Plan. They also earn no further Social Security credits. Forcing a worker to take reduced FECA benefits at some age deemed to be retirement age would cause grave economic hardship to many disabled employees. According to a GAO Report released earlier this year (GAO 13-108) the government-wide FECA cuts proposed in this legislation would have a disproportionate impact on the lowest wage workers and those injured early in their federal service careers.

NTEU also opposes elimination of the FECA family benefit. This is not a complicated program to administer. It does not compensate for the tragic emotional burden a head of household must suffer having lost his or her ability to continue as the breadwinner for his or her children. But it does provide some modest additional payment so a former family breadwinner can still provide some material support for his dependents.

NTEU is committed to a safe and healthy federal workplace where employees are less likely to suffer the injuries that lead to FECA claims. Our union has also been one of the strongest forces for innovation in the federal workplace, often working with management on bold new programs and sometimes dragging management forward over its reluctance. We have received reports from our members about management resistance or disinterest in light duty assignments, alternative worksites, disability accommodations and other actions that could allow FECA recipients to return to work. A change in management practices and culture is needed. While this is not something Congress can legislate, the first step is to end the myth that able bodied workers are receiving FECA payments and accept the fact that many injured workers would like to return to work and could do so with open minded and innovative agency practices.

Further, NTEU is willing to work with policymakers to improve program integrity methods. We support the cost savings provisions included in the bi-partisan legislation that was considered in the House in the last Congress including the anti-fraud and program integrity provisions. We strongly believe these are the types of reforms that should be explored before Congress moves to cut these social insurance benefits to injured federal workers.

S. 1486 would also allow the Postal Service to bargain with its unions to eliminate the Federal Employees Retirement System (FERS) defined benefit annuity for new Postal Service hires. This would strip these employees of a major element of their FERS retirement package and sets a dangerous precedent for the rest of the federal workforce. In addition, the bill would make changes to the employer contributions to the Thrift Savings Plan (TSP) for postal employees. This could lead to increased costs for all TSP participants and should not be enacted into law.

When FERS was created in the 1980s, it was designed to provide a modest pension for federal workers, and to replace the earlier Civil Service Retirement System (CSRS) which provided a defined retirement benefit. FERS has been referred to as a model by pension experts as diverse as David John, senior research fellow at the Heritage Foundation, Norman Stein, pension consultant and professor at Drexel University and Leigh Snell of the National Council on Teacher Retirement. (Diane Rehm Show, NPR, 10/8/10). In addition to being a model plan, the creation of FERS helped to shore up the ailing Social Security System by adding federal employees and their contributions to the system for the first time.

There are three parts to FERS: the defined annuity, Social Security and the Thrift Savings Plan which is similar to a 401(k) plan. All three are necessary to provide an adequate income in retirement. The average FERS annuity is about $1300 per month or approximately $15,600 a year. No one is getting rich on a FERS annuity. Eliminating the defined benefit portion for new postal hires is a slap in the face to postal workers who like their federal employee counterparts; seek a safe and modest retirement, like every American. NTEU will not support efforts to eliminate the defined benefit portion of FERS annuities for postal workers.

Thank you again for the opportunity to provide testimony on S.1486.

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November 22, 2013

The Honorable Thomas R. Carper
Chairman, Senate Homeland Security
& Governmental Affairs Committee
340 Dirksen Senate Office Building
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The Honorable Thomas Coburn
Ranking Member, Senate Homeland Security
& Governmental Affairs Committee
172 Russell Senate Office Building
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Dear Chairman Carper and Ranking Member Coburn,

Thank you once again for inviting me to testify during Part II of your hearing on Reforming and Renewing the Postal Service. I also want to thank you for continuing the dialogue with NALC about the future of the Postal Service after the hearing. We remain committed to building consensus around a package of reforms that will allow the Postal Service to build on its return to operational profitability in fiscal 2013 and surging success in the booming e-commerce sector without damaging service cuts or unwarranted changes to postal employee pay, benefits and collective bargaining rights.

I did not receive any follow-up questions after the hearing. But I note that my counterparts at the NRLCA and APWU did receive questions after they testified in Part I of the hearing – and they were given until November 22 to respond. With that deadline in mind, I write to address three topics that arose during the hearing to help the committee as it moves forward -- the issue of unfunded liabilities, the wisdom or risk of investing the PSRHBF's assets in private sector securities, and the comparability of postal employee compensation.

First, there was great attention paid during the hearing to the Postal Service's unfunded liabilities. Table 1 of the GAO's testimony presented data on "Selected USPS Liabilities and Unfunded Pension and Health Benefit Liabilities, Fiscal Year End 2007 through 2012." It showed $96 billion in unfunded liabilities. But a selective presentation on liabilities distorts the financial condition of the Postal Service. A full picture would include the Postal Service's assets as well as its liabilities. Those assets exceed $430 billion. See Attachment 1 to this letter.

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For example, the GAO chart excluded the Postal Service's $85 billion in real estate assets (market value) and failed to place the Postal Service's pension funding in context by providing data on its assets in the Civil Service Retirement and Disability Fund. Taken altogether, the Postal Service's assets cover all of its liabilities. And the Postal Service's pension funds are extremely well funded. There is a surplus in the FERS postal account the CSRS account is 91% funded – even measured with OPM valuation methods that discriminate against USPS.

As my submitted testimony makes clear, if the OPM were required to use postal-specific assumptions and the private sector accounting standard for retirement benefits (FASB-ASC 715), the Postal Service's pensions would be massively overfunded ($60-$65 billion). But even with the OPM's inappropriate methods, the Postal Service's pensions would be strongly in the Green Zone under the Pension Protection Act's standards for multi-employer pension funds like FERS and CSRS – that is, they are far more than 80% funded. (We note this standard for pensions lends support to your proposal for an 80% funding target for retiree health benefits.)

I am pleased that there seems to be consensus on the need to use postal-specific assumptions in the valuation of the Postal Service's retirement accounts. However, Chairman Carper indicated during the hearing that there was no consensus on addressing the dispute over the methods used by OPM to allocate liabilities for pre-1971 service under CSRS (as revealed by private sector audits commissioned by the PRC and OIG). In fact, there was a consensus in 112th Congress to do just that.

A bipartisan majority of 234 Members of the House of Representatives co-sponsored H.R. 1351 and the pre-cursor bills to S. 1789 both required the OPM to apply FASB Accounting Standard Codification 715 to the CSRS valuation. And in September 2011 the Obama administration supported a transfer of the postal surplus in CSRS that would result from its application as part of comprehensive postal reform (see Attachment 2). Moreover, the GAO's September 2011 review of the matter concluded that the PRC and OIG methods were as "reasonable" as OPM's current methods and that the choice of methods was a "policy decision" for Congress.

The Postal Service's balance sheet is much stronger than suggested by the GAO, and Congress could strengthen it even more if it required the OPM to treat the Postal Service fairly on its pension valuations.

In our view, the GAO's discussion of the Postal Service's alleged unfunded liabilities is incomplete and lacks context. It should not be used to justify short-sighted service cuts or proposals to discriminate against new postal employees when it comes to pension and health benefits. New postal employees deserve the same benefits that all other new and current federal workers, including those employed by the legislative branch.

Second, at least two witnesses, Douglas Holtz-Eakin and the GAO's Frank Todisco, and one or two senators expressed concerns about investing the assets of the Postal Service Retiree Health Benefit Fund (PSRHBF) in private securities to reduce the cost of pre-funding. NALC strongly supports this proposal. No private company would invest 100% of a fund meant to pay for future retiree health benefits over the next nine decades in low-yielding Treasury securities. Yet that is what the OPM does with the PSRHBF. This raises the cost of pre-funding for the Postal Service, which passes it on to its business customers. It makes no sense to invest the PSRHBF's assets in Treasuries earning 3.0-3.5% when the health care costs are expected to rise by 5.5-7.0% annually over the long run. The cost this imposes on the Postal Service and its ratepayers starves the Postal Service of investment capital and strangles the kinds of innovation needed to keep the Post Office relevant for the 21st Century.

NALC has proposed, and the Postal Service supports, investing the PSRHBF into established, well-diversified index funds like those offered by the Thrift Savings Plan. During the hearing, witnesses expressed varying levels of support to this idea. Among skeptics and opponents there appears to be some concern that taxpayers might be exposed to investment losses if we invested the PSRHBF in TSP-like funds.

It is true that markets rise and fall over time – as we saw during the Wall Street crash of 2008. But the PSRHBF has an extraordinary long time horizon over which it must finance benefits (92 years). At the same time, the annual cash flow needs of the Fund – the Postal Service's cost for retiree health premiums ($2.7 billion) -- is very small relative to the assets in the retiree health fund ($49 billion). This means the PSRHBF is very well positioned to ride out any market volatility without risking the need for taxpayer support. Indeed, the TSP's index funds have all recovered from the 2008 crash.

The whole point of setting up the PSRHBF was, allegedly, to protect the taxpayers from costs that ratepayers should pay. Although NALC does not see any problem with the Postal Service receiving taxpayer support (as other agencies do) for retiree health benefits, we believe the best way to protect the taxpayers' interest is to invest the PSRHBF intelligently. Leaving the ratepayer-funded assets of the Fund in low-yielding Treasuries over 90 years actually increases the likelihood of a "taxpayer bailout"-- by suppressing the long-term returns to the Fund. Investing in a well-diversified, safe index fund is both smart and safe. It will also help reduce the federal deficit by increasing the value of investments held on the OPM's balance sheet.

During the hearing, one senator questioned whether any long-term investment was offering guaranteed returns of 5.0% annually. Of course, that is rare today. However, over many decades, investment experts believe that annual returns of 5.0% or more are very likely for money invested in private sector securities. Our consultants at Towers Watson, who provide services to the NALC's FEHBP health plan and to the trustees of the NALC's investment accounts, have confirmed this. At our request, they investigated the long-term impact of investing money in the TSP's Lifecyle 2050 Fund. (The 2050 Fund provides a mix of large- and small-cap stocks, corporate bonds, international securities and government bonds for participants who expect to need their savings in the year 2050.) They concluded that such an investment would likely earn slightly more than 7.0% annually over the long term. If the PSRHBF were so invested, we could roughly double the rate of return it now earns and provide significant relief to postage rate payers while protecting the interest of taxpayers.

Finally, I would like to respond to a couple of statements that were made about the comparability of postal employee compensation. Before doing so, I would emphasize that the issue of comparability is very complex and necessarily involves careful analysis of the characteristics of workers, their jobs, their working conditions as well as the size and nature of their employers and the industries in which they toil. It is therefore very difficult to draw accurate conclusions from overly broad comparisons between "federal employees" and "private sector employees."

For example, during the hearing, Dr. Coburn introduced into the hearing record a 2010 analysis of pay rates published in the *USA Today* ("Federal Workers Earning Double Their Private Counterparts"). A chart labeled 'Pay Rates' shows that total compensation averaged $123,049 annually in 2009 in the federal government versus $61,051 in the private sector. Senators may find the difference in pay surprising, but it should not be since the federal workforce is predominantly full-time and staffed with career employees who are older, more experienced, and heavily weighted with highly educated professionals (doctors, scientists, lawyers, etc) compared to the private sector.

Even if the *USA Today* figures are accurate, they tell you very little about the issue of comparability, especially about postal employee pay comparability. For my union, the pay of utility workers and delivery workers employed by other large national delivery companies (FedEx and UPS) has defined comparability. The Postal Service has its own more complicated (though, in our view, less accurate) metrics. And every time we bargain with the Postal Service we mutually refine the definition of comparability.

Senator Johnson also raised the issue of postal pay comparability in his questioning of witness Holtz-Eakin. He cited the $120,000 average cost of compensation for federal workers and asked: "And you can see in terms of benefits, $35,000 for a postal worker, $10,000 for [the] private sector. Dr. Holtz-Eakin, can you comment on [this] – how did it get that outsized?" The witness declined to comment, but I'd like to respond with two points. One, the average salary of current postal employees (bargaining unit only) is $51,210 annually ($24.62 per hour) and average pay (including overtime and accrued leave) is $54,426 annually ($26.16 per hour). This is far less than the average salary figures for the government overall. Two, given that the average cost of benefits currently stands at 31% of pay, the average value of benefits comes to

November 22, 2013
Page 5

$16,872 annually – far less than the $35,000 cited. (See Page B of the National Payroll Hour Summary Report for PP13-2013 for source data.) Once you control for the relevant factors (i.e., age, tenure, full-time status, industry, employer size, etc.) there is no reason to believe that postal employee benefits exceed those of comparable national employers in the delivery industry. (See Attachment 3 for a partial analysis).

Sen. Johnson's comparison was too imprecise. The Postal Service is a single enterprise and the second largest employer in the country. Most of its bargaining unit workers are full-time career employees in an industry dominated by large multinational companies. The average benefit costs of the private sector overall reflects the compensation policies of millions of businesses as they relate to a workforce that is dramatically different than the Postal Service's workforce. Most obviously, most private sector employees don't work in the national delivery industry. The vast majority work for very small companies in local markets, with high percentages of small food and retail establishments. They are younger and less experienced than USPS employees. A much higher share of private sector workers have part-time, temporary jobs that often pay no benefits at all–which lowers the average for the private sector.

I raise these issues not to criticize or quarrel with Dr. Coburn or Sen. Johnson. Indeed, I believe they both contributed to one of the best hearings on postal reform the Senate has ever had. Rather I do so to underline my first point on this topic – that this is very complicated stuff. For this reason, Congress has wisely left the definition of postal pay comparability to the collective bargaining parties involved.

If Congress adopts the right package of reforms there is every reason to be optimistic about the future of the Postal Service. Indeed, the recent expansion of delivery to seven days a week (with package service for Amazon packages and other shippers who want it) shows the potential of our unmatchable first- and last-mile networks. Indeed, according to the Postal Service's Integrated Financial Plan, it expects to earn an operating profit of $1.1 billion in 2014. Now is not the time to eliminate Saturday letter delivery or to-the-door service and thereby drive business away from the Postal Service.

We look forward to working with you on successful postal reform. If allowed to innovate and grow with your help, the Postal Service is poised for a very strong comeback.

Sincerely,

Fredric V. Rolando
President

Attachments

Attachment 1

USPS Assets and Liabilities (September 30, 2012)

Item	Liabilities $bil	Assets $bil		Over/(Under) funded [1]
Debt [2]	$15.0	$0		$(15.0)
Workers' comp liabilities (current and long-term)[3]	$17.6	$0		$(17.6)
Retiree Health Benefits[4]	$93.6	$45.7		$(47.9)
CSRS [5]	$209.9	$191.2		$(18.7)
FERS [5]	$90.5	$93.5		$3.0
TOTAL OF ABOVE	**$426.6**	**$330.4**		**$(96.1)**
Market Value of USPS Buildings and Land [6]	$-	$85.0		$85.0
Equipment, Leasehold improvements, Construction in progress	$-	$21.7		$21.7
TOTAL WITH MARKET VALUE OF REAL ESTATE, EQUIPMENT, LEASEHOLD IMPROVEMENTS, AND CONSTRUCTION IN PROGRESS	**$426.6**	**$437.1**		**$10.5**

[1] The fourth column above contains the 2012 unfunded liabilities presented on page 2 of the 9/26/2013 GAO testimony before the Committee on Homeland Security and Governmental Affairs, U.S. Senate. The GAO testimony did not provide the assets or liabilities that made up these calculated figures (they are provided in the columns above). In addition, the GAO did not provide the value of USPS Real Estate Assets, estimated by the USPS OIG to be $85 billion, or the value of other USPS property.

[2] Debt line item above reflects borrowing incurred under the USPS $15 billion credit facility with the US Treasury.

[3] The long-term portion of the workers' comp liability above ($16.2 bil of the total, or >92%) is very susceptible to increases and decreases in interest rates.

[4] Retiree Health Benefits amounts were calculated as of Sept 30, 2012 and do not reflect the significant decrease in the RHB Liabilities that would result from Medicare integration.

[5] The above valuations of Postal Service FERS and CSRS liabilities are based on OPM's actuarial measurements, which use the same inputs (e.g. wage growth, demographics, economic assumptions, etc.) for all federal employees. OPM's FY2012 measurements resulted in a $3.0 billion surplus in FERS and an $18.7 billion unfunded liability in CSRS. Had Postal Service employee-specific actuarial measurements been used, The Hay Group (retained by the USPS OIG) estimated that the FERS surplus would have been $12.48 billion as of Sept 2012 (see Dec 4, 2012 report).

In addition, in January 2010 The Hay Group (retained by the USPS OIG) conducted an analysis on the allocation of pension funding responsibility between the U.S. government and the Postal Service. If Hay's allocation methods were applied, the Postal Service's FY2009 CSRS surplus was estimated at $75 billion. In June 2010, The Segal Company (retained by the PRC) conducted an analysis on the allocation of pension funding responsibility between the U.S. government and the Postal Service. If Segal's allocation methods were applied, the Postal Service's FY2009 CSRS surplus was estimated at $50-$55 billion.

[6] Source: USPS OIG real estate valuation source: 6/2012 OIG Report "Pension and Retiree Health Care Funding Levels, Management Advisory Report" http://www.uspsoig.gov/document/audit-report/pension-and-retiree-health-care-funding-levels

Attachment 2

THE WHITE HOUSE

WASHINGTON

October 13, 2011

The Honorable Darrell Issa
Chair
Committee on Oversight and Government Reform
Washington, D.C. 20515

The Honorable Elijah Cummings
Ranking Member
Committee on Oversight and Government Reform
Washington, D.C. 20515

Dear Chairman Issa and Ranking Member Cummings:

As the House Oversight and Government Reform Committee considers legislation to reform the United States Postal Service (USPS), I wanted to provide you with the Administration's views regarding an option some have suggested to reallocate the relative shares of responsibility for USPS Civil Service Retirement System (CSRS) benefits. After considerable review the Administration concluded that under current law the CSRS allocation could not be changed. While the Administration recognizes that there are competing views as to whether the statutory allocation was proper, the Administration believes the key point now is that we are all trying to take steps to ensure the future viability of the Postal Service which is critical to the Nation's commerce and communications.

The President has put forward a specific and balanced plan that would help the USPS make structural reforms to increase its revenues, reduce its costs, and provide temporary financial relief to allow it time to put in place its new business model, a plan that would protect taxpayers and reduce the budget deficit. The Administration believes Postal Reform legislation should contain these three elements and would be open to considering a balanced legislative plan that instead included alternative forms of financial relief, such as a transfer from the Civil Service Retirement System (CSRS) to the USPS.

Sincerely,

Robert L. Nabors, II
Assistant to the President and
Director of the Office of Legislative Affairs

Attachment 3

BLS Employer Wage Costs, September 2012

	Hourly Rate	Percent of Avg. USPS Wage	Percent of Avg. City Carrier Wage
Private sector workers (all firm sizes, all industries, union & non-union)	$20.36	80.0%	76.4%
Full-time (all firm sizes, all industries, union & non-union)	$23.22	91.1%	87.2%
Union, service providers	$23.33	91.6%	87.6%
Union, all industries	$23.51	92.3%	88.3%
Large service firms (500+ establishments)	$27.91	109.5%	104.8%
Large firms (500+ estab), all industries	$28.08	110.2%	105.4%
Utilities	$35.86	140.7%	134.6%
Average USPS Wage	**$25.48**	**100.0%**	-----
Average City Carrier Wage	**$26.64**	-----	**100.0%**

Source: Bureau of Labor Statistics and USPS payroll records.

SENATE HOMELAND SECURITY AND GOVERMENTAL AFFAIRS COMMITTEE
"Outside the Box: Reforming and Renewing the Postal Service,
Part II – Promoting a 21st Century Workforce"
September 26, 2013

Post-Hearing Questions for the Record
Submitted to the Honorable Patrick Donahoe

From Ranking Member Tom A. Coburn:

1. In your testimony, you noted that "Postal Service has been the second-largest employer contributor of Medicare taxes." How did you arrive at that calculation?

   Answer:

   Since 1983 the Postal Service has paid more than $27 billion into the Medicare Trust Fund—$13.7 billion paid directly by the Postal Service for our employer share of Medicare, and $13.7 billion paid by our employees.

   Our Finance Department, working with outside consultants, has researched this contribution level and compared it to other employers and concluded that the Postal Service is the second largest employer contributor to Medicare in the United States. The Department of Defense is the largest contributor.

   By not integrating Postal Service retiree health care with Medicare, Postal Service employees and annuitants pay more for their health care premiums than private sector retirees who are universally required by their employers to enroll in Medicare when eligible.

   It bears noting that the Postal Service is not like the rest of the federal government in that we are not an appropriated agency. As an independent entity, the Postal Service carries the legacy cost liability for its annuitants just like a private sector business. As such, we are simply asking to be treated as any other private sector employer or state and local government.

2. Currently, Postal Employees receive their health coverage through the Federal Employees' Health Benefits Program. FEHBP is one of the nation's largest employer-based health coverage plans, with roughly 8 million covered lives. The U.S. Office of Personnel Management (OPM) has announced the average premium rate for the 8.2 million people covered by the FEHBP will increase by only 3.7 percent in 2014. That percentage is less than the national average increase in 2013. For the third year in a row, OPM has kept the average premium increases for the FEHB Program under 4 percent. This year there are also more plan choices: 256, up by over 10 percent from 2013. Do you believe you will have better buying power for the remaining Postal employees inside or outside of FEHBP? Why?

Answer:

We heard the concerns and doubts from our unions and management associations about a Postal Service Health Care Plan outside of Federal Employees Health Benefits Program (FEHBP). Those concerns included preservation of FEHBP administration, plan choice, federal purchasing power, insurance premium cost containment, the impact on FEHBP of a Postal Service active employee and annuitant departure, and the many other advantages of a large federal active and annuitant pool. As a result, we continued to work with our unions and management associations on an alternative proposal that would accomplish our objectives within FEHBP.

The Postal Service is now seeking legislation directing the Office of Personnel Management (OPM) to identify all Postal Service participants (active and retired) currently within FEHBP and the plans they have chosen. Those plans with more than 5,000 Postal Service active employees and annuitants would be segregated for accounting and legislative direction effective with the Plan Year 2015. The legislation would require these segregated plans to mandate all Postal annuitants age 65 and over and any dependent spouse age 65 and over who are eligible for Medicare to enroll in Medicare Parts A and B. The legislation would also mandate that prescription drug benefits for these annuitants be provided through Medicare Part D Employer Group Waiver plans.

We believe this new legislative pursuit allays all of the concerns noted above while still achieving our primary objective—allowing the Postal Service to effectively integrate our retiree health care with Medicare and, thereby, fulfilling our commitment to providing retiree health care for our annuitants in the future.

Finally, as to better buying power, the effect of combining the purchasing power for health benefits under a single Postal Service sponsored plan is significant. While the largest plans within FEHB certainly have equivalent purchasing power to Postal Service, that purchasing power is dissipated through the maintenance of more than 200 plans, many of which are very small, though in the aggregate they cover a significant share of the participant population. These savings from consolidation of the plans are projected to be approximately 8 percent of premiums.

3. One of the things we have tried to do in this bill is allow you to run your business like a business. While our bill does not mandate such a move, can you talk about the importance of moving new employees away from defined benefits and into defined contributions?

Answer:

The Postal Reorganization Act of 1971 mandated that Postal Service salaries and benefits be comparable to those provided in the private sector. There is no question that the legacy cost issue—both pensions and retiree health care—is an enormous challenge in the United States. We believe the retiree health care issue can be effectively addressed by following the universal practice with regard to the provision of retiree health care in the private sector. We must integrate the segregated Federal Employees Health Benefits Program (FEHBP) plans noted above with Medicare Parts A, B, and D.

As for pensions, only a small and declining percentage of private sector employers provide a defined benefit pension plan. The vast majority of employers provide a defined contribution plan or 401(k) match. The Postal Service would like to follow the private sector trend for new career hires and provide a defined contribution pension program, integrated with Social Security, which is competitive, portable and affordable long term. While the growth of defined contribution plans has largely reflected financial considerations for plan sponsors, including efforts to constrain costs and manage the volatility in plan costs that is characteristic of defined benefit pension plan funding, it is important to note that certain advantages are also perceived by participants in defined contribution plans, compared with defined benefit plans.

Such advantages include:

- The benefits and the accumulating value in the participant's retirement plan accounts are reflected in periodic statements. In today's world, participants can access information about the plan, the performance of their investment choices and their account balances daily. The benefit is thus more tangible and visible than benefits provided under a defined benefit plan, especially for younger plan participants;
- The benefit is readily portable, since on termination of the participant's employment the balances accrued, subject to the provisions of the particular plan, can be:
  - Maintained in the former employer's plan; or
  - Rolled over to a rollover Individual Retirement Account; or
  - Rolled over to a successor employer's plan;
- Benefit distribution options are virtually unlimited at retirement or termination of employment. Participants have the option to receive their benefit:
  - In a single lump sum, paid in cash or rolled over to an IRA; or
  - Annuitized either through the plan or through an annuity purchase outside the plan, with annuity terms (single life, joint life, deferred annuity, etc.) chosen by the participant; or
  - Some combination of the prior two options, i.e. receive part of the distribution in a lump sum and annuitize the residual amount; and
  - The decision to annuitize can be made at retirement, or later as the participant's needs and investment considerations dictate
- Participants can tailor their investment choices to meet their particular needs, including taking into account such factors as:
  - Their personal risk tolerance;
  - The time horizon remaining until they will need to use the funds accumulated for income after retirement;
  - Other retirement income assets; and
  - Other factors which will influence their investment choices.
- Participants have greater control over their savings over their working career, can modify their savings rate to adjust to changing circumstances, and can access a portion of their account to meet immediate needs such as financing a home purchase.

If the Postal Service can achieve these two objectives, we believe the legacy cost issue for the institution becomes manageable long term.

From Senator Heidi Heitkamp:

1. In making such significant changes to health care and retirement provisions as you are proposing, and that are contained in S. 1486, what concerns do you have about being able to attract the vibrant workforce you need so the Post Office can innovate and meet the challenges of the next 20 years?

   Answer:

   The Postal Service is a service business and, as such, it is inherently labor intensive. The success of the institution depends upon our ability to recruit, retain and promote a qualified work force. Even with the changes we have made in the last round of bargaining, and those we seek through new legislation, we believe the Postal Service presents an outstanding compensation and benefits package compared to the private sector. Our career voluntary quit rate is roughly one percent—a fact often noted by Postal interest arbitrators as proof of a Postal wage and benefit premium relative to the private sector. We have no doubt that we will continue to attract a vibrant and well qualified workforce going forward.

2. In reading the testimony from the postal stakeholders and unions for both this week and next week, it is abundantly clear that they feel as if the average postal worker has made significant sacrifices to help the Postal Service get through very challenging financial difficulties, and that the retirement and health care changes that are allowed in S. 1486 are a bridge too far and not workable or fair. Both GAO and OPM's testimony includes various concerns about these proposals, but also indicate that there is some potential to realize some savings – if everything works out the way it is supposed to. What data can you show me that demonstrates USPS has the expertise to manage its own health care plans and ensure that current postal workers, current retirees and future retirees will be protected and treated fairly with regards to both health care and retirement benefits?

   Answer:

   In either scenario, the Postal Service was not going to administer the plan on our own. Under our original proposal to leave FEHB we planned to have a competitive bidding process and establish a contract with health care provider to manage the plan. The Postal Service now has experience with health care plan administration given the new plan established in January of 2013 for our noncareer complement. This plan was designed, in consultation with our benefits consultants at Aon and PRM Consulting, to comply with the Affordable Care Act and was put out for competitive bid outside of FEHBP. It is administered by United Healthcare. Most Fortune 500 companies provide health care benefits to their employees by working with benefit consultants to design the features of a best practices health care plan and then put that design out for competitive bid in the marketplace. The successful

bidder—BCBS, Aetna, United Healthcare, Kaiser, or some other insurer--becomes the administrator of the health care plan.

As previously discussed, our current proposal to remain within FEHB would leave the administration of the plans to OPM as it is today for all FEHB plans.
The Postal Service is well aware of the concerns raised by our unions and management associations in regards to a Postal Service Health Care Plan outside of Federal Employees Health Benefits Program (FEHBP). It is the principal reason why we have worked with them to address the retiree health care issue within FEHBP as noted in the answer to Senator Coburn's question number 2 above. Again, we believe that our total compensation package is now, and will remain in the future, an attractive inducement for Postal Service employment.

From Senator Carl Levin:

1. In your testimony to this committee on September 19, you answered a question from Senator Coburn whether "It is presently the law that an arbitrator cannot consider the financial health of the USPS in arbitrating a labor dispute with the Post Office..." You answered "that is correct."

   Yet Section 1207 of Title 39 of the US Code that pertains to Postal Service labor disputes does not seem to contain any language which prohibits arbitrators from considering any factor they deem relevant in rendering their decision. Please provide the legal basis for your concurrence that arbitrators cannot consider the financial health of the USPS in arbitrating a labor dispute.

   Answer:

   As I noted to Senator Tester at the September 26, 2013 hearing, I misspoke when answering Senator Coburn's question at the September 19, 2013 hearing. The correct answer is that the law does not *require* an arbitrator to consider the Postal Service's financial condition when rendering a decision. The correct description of current law was provided on page 13 of my written testimony.

From Senator Mark L. Pryor:

1. On September 26, the United States Postal Service filed an emergency rate increase request that will increase rates for market dominant products by an average of 5.9 percent, effective January 2014. Under current law, does the Board of Governors of the United States Postal Service approve an exigent rate request?
   a. Would S. 1486, the Postal Reform Act of 2013, have the Board of Governors both decide whether to propose an exigent rate increase and also decide whether to implement that rate increase?
   b. Is there an advantage to removing the 90 day review period by the independent Postal Regulatory Commission?

Answer:

As an initial matter, please note that the Postal Service has requested an average increase of 4.3 percent in its exigent request, not 5.9 percent. The latter figure refers to the average of the exigent increase in combination with the price cap-based increase also filed at the Postal Regulatory Commission (PRC) on September 26, 2013.

The Presidentially-appointed Governors of the Postal Service, rather than the full Board, approves the filing of an exigent rate request. The request is filed with the PRC, who must approve the request before it can be implemented.
The bill as introduced would give the Board of Governors the ability to approve an above-cap increase due to extraordinary or exceptional circumstances if they unanimously determine that such an increase is necessary to maintain and continue the development of postal services adapted to the needs of the United States. Persons who feel that the Board of Governors has acted contrary to law would be able to file a complaint with the Commission.

The Board of Governors believes that postal reform legislation should not simply make incremental reforms to address the current liquidity crisis for the near term, but should give the Board the tools to proactively address Postal Service costs and revenue challenges in order to maximize the possibility that financial stability can be maintained over the long-term. To accomplish this goal, the legislation must clearly match authority with responsibility. Under current law, the Board of Governors has the responsibility of ensuring the provision of universal postal services in a financially self-sufficient manner, but it lacks the authority to effectuate that responsibility.

Giving the Board of Governors the authority to ensure that the rates charged by the Postal Service are sufficient to continue and maintain the development of postal services adapted to the needs of the United States is consistent with matching authority and responsibility. Under this approach, the PRC's role would be that of an adjudicatory body hearing a complaint that the Board has acted contrary to the law, rather than a body whose prior approval, based on a *de novo* review of the statute, is necessary. An adjudicatory role for the PRC properly reflects what should be the policy-making prerogatives of the Board. In addition, a more limited regulatory role for the PRC, compared to current law, would also properly reflect the fact that—because of the numerous competitive alternatives to the use of the mail—the Board has very strong incentives to ensure that the rates it sets are reasonable and do not make the mail an unattractive medium for communications and commerce. Because these competitive alternatives prevent the Postal Service from setting excessive prices, extensive regulatory controls over Postal Service prices are unnecessary.

Post-Hearing Questions for the Record
Submitted to Jonathan Foley
From Senator Carl Levin

"Outside the Box: Reforming and Renewing the Postal Service, Part II – Promoting a 21st Century Workforce"

September 26, 2013

1. With regard to the Postal Reform Act's proposed changes to USPS health care in Section 104 and 105, I am concerned about the potential for cost shifting from USPS to other federal agencies that will ultimately be borne by taxpayers. In particular, CBO noted last year that a provision similar to Section 105 of the Postal Reform Act would save USPS $1.2 billion, but ultimately cost taxpayers $1.8 billion because of cost shifting to other federal agencies. What portion of the proposed savings in both Section 104 and Section 105 of the current Postal Reform Act are due not to cost reductions, but by shifting the cost of retirees from the Postal Service to Medicare?

   Section 104 removes Postal Actives from the existing FEHB single risk pool. These changes result in a cost shift from the Postal Service and Postal enrollees to Federal Agencies, the US Treasury, and non-Postal enrollees; however CBO has not estimated the amount of this shift.

   Section 105 would through lower annuitant premiums and waiver of the Part B late enrollment penalty encourage annuitants without Medicare Part B to join Part B on a voluntary basis. Assuming present Postal annuitants without Part B purchased it during the enrollment period, we expect that there would be additional Part B benefit payments and costs to Medicare. Part B would also forgo late enrollment penalties. CBO has not provided an estimate of the cost increase to Medicare as a result of this provision.

2. A CBO report suggests that most remaining non-postal employees will be subjected to about a 2% increase in FEHBP premiums, but some non-postal employees could see costs increase by up to 35%. How would these increases impact federal agencies, other than USPS, which pay a large share of their own employees' premiums?

   Plans with high premium increases would see large enrollee premium increases, however the government contribution is capped. The remaining non-Medicare Postal annuitants, who often remain in the more expensive plans they chose as actives, are likely already receiving the maximum government contribution.

3. If the USPS created a new postal specific health plan administered by the FEHBP, would this impact the risk pool of FEHBP or increase the premium for non-postal employees?

   If postal employees and retirees are removed from the FEHB Program risk pool, we estimate that costs under the original FEHB Program risk pool would increase by about two percent per enrollee.

Post-Hearing Questions for the Record
Submitted to Jonathan Foley
From Ranking Member Tom A. Coburn

"Outside the Box: Reforming and Renewing the Postal Service, Part II – Promoting a 21st Century Workforce"

September 26, 2013

As you know, in the President's FY2014 Budget proposal, he proposed modernizing the FEHB program by allowing the Office of Personnel Management (OPM) to contract with modern types of health plans rather than being limited to the current four statutorily defined plans reflective of the 1960s insurance market.

1. Please comment on this proposal and outline the likely impact resulting from modernizing and updating the health care choices available under the Federal Employee Health Benefit Program, as proposed in the President's budget, which could be available to all federal employees, including potentially postal employees?

   The health insurance marketplace has changed significantly since the Federal Employees Health Benefits (FEHB) Program began over 50 years ago, and the current contracting structure reflects largely outdated distinctions. The current structure includes only national and local health plans. However, there are no large regional players. The proposal to add regional plans would improve the range of options available within the Program.

   The ability to contract with strong regional plan types currently available in the private market would enable OPM to increase competition and respond to the change in the health insurance market. FEHB enrollees would benefit from having greater choices that represent best practices in the private sector and more closely resemble product combinations available in private industry as well as in state and local government employee programs. As with standard contracting procedures, each health plan would still need to meet qualifying criteria like that currently in place for plans in the FEHB Program. This proposal would simply provide OPM with the ability to consider additional plan types and contract with plans only when it is in the best interest of the FEHB Program and its enrollees.

2. As you know, CBO released a preliminary score for all the health-related provisions included in the President's budget, including this provision to open the FEHBP to more choice and competition. CBO's preliminary estimate was based on a concept, and not specific legislative language and suggested this provision will score. However, CBO's assumptions differ from the OPM's estimate that this provision will save $260 million over 10 years. Do you believe that CBO adequately accounted for the historical experience of OPM's successful program management and the wide array of plan

management tools that OPM has at its disposal to minimize disruption and maximize savings for enrollees in the program? If not, how would change the score?

We believe OPM has a long record of managing the FEHB marketplace and that we would be able to preserve stability while allowing for additional product choices and enhanced competition from regional plans.

OPM has several tools available to minimize disruption and maximize savings. During annual contract negotiations, OPM will encourage regional PPOs to propose service areas where there is currently less FEHB competition. OPM expects to hold new regional PPOs to higher MLRs than local plans which will result in savings long term.

OPM expects to use a phased-in approach to monitor the impact of regional plans on the FEHB Program as a whole.

OPM and CBO differ in their assessment of the budget implications of this proposal. The difference in estimates stem from divergent assumptions about changes in plan participation in FEHBP, the medical-loss ratios of plans entering the market, and movement of enrollees between participating plans.

3. Regarding modernizing the types of plans allowed in FEHBP, does it seem counter intuitive to you that increasing choice and competition in the FEHBP would lead to higher costs in the Program?

   Yes, we believe it is counter-intuitive. The very principles upon which the FEHB was built, actual consumer choice and competition, have contributed to a model employer-sponsored insurance program that has maintained reasonable program costs for decades.

4. What other considerations are important for this Committee to take into account regarding how to construct Postal Reform in a manner that preserves the stability of the FEHB program?

   As the Committee moves forward with Postal Reform, we would encourage the Committee to think about:

   - *the impact of Postal reform on non-USPS beneficiaries*
   - *structuring cost-sharing so as to encourage efficient utilization of medical services, particularly for Postal retirees eligible for Medicare*
   - *the potential for increased costs to the Medicare program and across the federal government*

GAO
Accountability * Integrity * Reliability
United States Government Accountability Office
Washington, DC 20548

November 21, 2013

The Honorable Thomas R. Carper
Chairman
Committee on Homeland Security and Governmental Affairs
United States Senate

Subject: *Responses to Questions for the Record; Committee on Homeland Security and Governmental Affairs, September 26, 2013, Hearing on "Outside the Box: Reforming and Renewing the Postal Service, Part II – Promoting a 21st Century Workforce"*

Dear Mr. Chairman:

This letter responds to your October 21, 2013, request that we address questions submitted for the record related to the September 26, 2013, hearing entitled, *Outside the Box: Reforming and Renewing the Postal Service, Part II – Promoting a 21st Century Workforce*. Our answers to these questions are enclosed and are based on our previous work, updates to that work, and our knowledge of the areas addressed. If you have any questions or would like to discuss our responses, please contact John E. Dicken at dickenj@gao.gov or call (202) 512-7114 or Frank Todisco at todiscof@gao.gov or call (202) 512-2834.

Sincerely yours,

John E. Dicken

John E. Dicken,
Director, Health Care

Frank Todisco

Frank Todisco,
Chief Actuary, Applied Research and Methods

The undersigned meets the qualification standards of the American Academy of Actuaries to render the actuarial findings contained in the answers to these questions for the record regarding the measurement issues, funding issues, and risks associated with pension and retiree health care obligations.

Frank Todisco, FSA, MAAA, EA
Chief Actuary

cc: The Honorable Tom Coburn, M.D., Ranking Member
Committee on Homeland Security and Governmental Affairs

The Honorable Carl Levin
Committee on Homeland Security and Governmental Affairs

Enclosure

Post-Hearing Questions for the Record
Submitted to Frank Todisco and John E. Dicken
From Senator Thomas R. Carper

"Outside the Box: Reforming and Renewing the Postal Service, Part II – Promoting a 21st Century Workforce"

September 26, 2013

1. **At the hearing, we asked that you submit for the record the amount that the Postal Service has paid into Medicare for its employees. Can you please provide that information as well as any information you have about how much Postal Service employees have paid into Medicare?**

   We do not have information on the amount of Medicare taxes that the U.S. Postal Service (USPS) or its employees have paid. Our July report notes that postal employees pay Medicare taxes.[1] Likewise, USPS pays the employer portion of the tax. Employers, in this case USPS, and employees each pay 1.45 percent of wages. This tax revenue finances Medicare coverage of hospital services, known as Part A. In 2011, of those postal retirees eligible for Medicare, 92 percent were enrolled in Medicare Part A. Medicare coverage for outpatient services (Part B) and prescription drugs (Part D) is funded with other sources of revenue, including premiums paid by enrollees.

[1] GAO, *U.S. Postal Service: Proposed Health Plan Could Improve Financial Condition, but Impact on Medicare and Other Issues Should Be Weighed before Approval*, GAO-13-658 (Washington, D.C.: July 18, 2013).

Post-Hearing Questions for the Record
Submitted to Frank Todisco and John E. Dicken
From Ranking Member Tom A. Coburn

"Outside the Box: Reforming and Renewing the Postal Service, Part II – Promoting a 21st Century Workforce"

September 26, 2013

1. **Your testimony notes that estimates of retirement benefits under FERS contain a "significant degree of uncertainty" and can change over time, and that "returning surpluses whenever they develop would likely result in an eventual unfunded liability." You suggest an alternative option – can you describe in greater detail these alternatives for the Committee and why you think they are a sound path?**

   Under current law, USPS realizes no financial benefit from any FERS surplus. We have reported on several options that would provide USPS some financial benefit whenever there is such a surplus, including amortization of the surplus, funding holiday, and return of the entire surplus. We explain each of these options in turn below.

   a. Amortization of the surplus: We have reported that under current law for funding USPS's FERS liabilities, there is an asymmetric treatment of deficits and surpluses.[2] When there is a deficit, USPS must make a 30-year amortization payment towards funding that deficit; this payment is added to USPS's regular "normal cost" payment, which is a payment for the growth in the liability attributable to the current year of employees' service. However, when there is a surplus, USPS gets no credit for this surplus to offset some or all of the normal cost payment. We have reported that this asymmetric treatment is arguably unfair.

      One remedy would be to reduce USPS's normal cost payment by amortizing the surplus over a 30-year period, mirroring the treatment of any deficit. Thirty-year amortization of surpluses or deficits results in gradual adjustments to funding requirements, in recognition of the inherent uncertainty of the liability measurement.

   b. Funding holiday: Under this approach, any surplus is used to fully offset USPS's required normal cost payment year after year until the surplus is used up. This approach is allowed for private-sector pension plans. It accesses a surplus more quickly than an amortization approach, but much less quickly than a return of the entire surplus.

   c. Immediate return of the entire surplus to USPS on a one-time basis: Thereafter, if any new surpluses develop, the amortization approach could be

[2] GAO, *U.S. Postal Service: Allocation of Responsibility for Pension Benefits between the Postal Service and the Federal Government*, GAO-12-146 (Washington, D.C.: Oct. 13, 2011).

used or the funding holiday approach. Whether or not to allow a one-time-only return of any FERS surplus is a policy decision for Congress. We have reported that a one-time-only return of the entire surplus should be considered as a one-time exigent action only as part of a larger package of reforms and restructurings. Some related considerations include:

- To some extent, any USPS FERS surplus would have accumulated because of the asymmetric treatment of such surpluses in the past, as noted above. A one-time-only return could be viewed in part as a remedy for this prior asymmetric treatment. Further, any additional surplus that is uncovered by a switch to USPS-specific assumptions could be viewed as part of that remedy.

- On the other hand, the FERS surplus could be considered in the context of USPS's much larger deficits for CSRS benefits and retiree health benefits, and even together with its liability for workers' compensation and its debt to the Treasury. (Note too that the funding rules that USPS must follow for FERS, CSRS, and retiree health benefits are all different – for example, with regard to timing, amortization periods, and treatment of surpluses and deficits.)

Regardless of Congress's decision regarding a one-time-only return of the surplus, thereafter the amortization or funding holiday approaches would be more fiscally prudent than allowing returns of future surpluses because they would reduce the chances of an unfunded liability emerging.

2. **Your testimony talks about the problems of deferring the impact of unfunded liabilities onto future generations. Relative to the prefunding of health care benefits, you suggest that only having an 80 percent funding target means, practically, that the Postal Service has a 20 percent unfunded liability. Moving forward to the next draft of this bill, what do you suggest the committee does to tackle the other 20 percent?**

   There are a number of options that the committee could consider. For example:

   (1) One approach would be to simply change the funding target to 100 percent in the next draft of the bill. We estimate that this would add roughly $1 billion to annual prefunding costs (when prefunding resumed in fiscal year 2016 under the bill's provisions); Congress would have to weigh the affordability of such higher payments given the overall financial impact of the bill. Also, note that if USPS is allowed to, and does succeed in, lowering its retiree health liability through increased retirees' use of Medicare – either within or outside of the Federal Employees Health Benefit Program – then the financial impact of a 100 percent funding target would be reduced as well, making 100 percent funding more affordable to USPS.

   (2) Another approach we have identified in the past would be to create a schedule to achieve 100 percent funding in a subsequent time period after the 80 percent level is achieved. For example, the Senate bill would build towards

approximately 80 percent funding over the period from fiscal year 2016 to fiscal year 2052. A second schedule could be created to get to 100 percent funding by some year subsequent to 2052. Relative to the first approach, this second approach would spread payments out over a longer period, fairly far into the future, introducing some risk as to the ability to pay in that subsequent period.

(3) A third approach could be to calculate prefunding amounts based on an 80 percent target for the first half of the period 2016-2052, but then to use a 100 percent target during the second half of this period. Relative to the first approach, this third approach would backload payments towards the second half of the period, introducing some risk as to the affordability at that time of such higher payments.

(4) A fourth approach could be to allocate some of any FERS surplus towards USPS retiree health care funding, in order to make a 100 percent funding target for USPS retiree health care more affordable to USPS.

Post-Hearing Questions for the Record
Submitted to Frank Todisco and John Dicken
From Senator Carl Levin

"Outside the Box: Reforming and Renewing the Postal Service, Part II – Promoting a 21st Century Workforce"

September 26, 2013

1. **Government agencies have previously offered employees alternative health insurance options outside of FEHBP, including most recently the Federal Deposit Insurance Corporation and the Federal Reserve. However, both agencies subsequently chose to discontinue the independent plans and rejoin FEHBP. Please discuss the lessons learned from those experiences and their relevance to the plan proposed in Section 104 of the Postal Reform Act.**

We found that the experiences of the Federal Deposit Insurance Corporation, the Federal Reserve Board, and the four other federal agencies that established their own health plans in the 1980's but later returned enrolled employees and retirees to FEHBP provide limited lessons for a USPS withdrawal from FEHBP. These agencies had far fewer employees than USPS and the demographics of their population may have differed from the USPS population, which is somewhat older than the rest of the population enrolled in FEHBP. One lesson learned that we noted in our July report was that, according to OPM officials, when the six agencies returned to FEHBP in the 1990's, the requirement for 5 years of continuous coverage in FEHBP prior to retirement to be eligible for FEHBP as an annuitant had to be waived for some retirees.

Post-Hearing Questions for the Record
Submitted to Douglas Holtz-Eakin
From Ranking Member Tom A. Coburn

"Outside the Box: Reforming and Renewing the Postal Service, Part II – Promoting a 21st Century Workforce"

September 26, 2013

1. Your testimony warns of costs shifts. Our bill allows the Postal Service to incentivize its employees into Medicare. The Postal Service and its employees pay roughly $250 million a quarter into Medicare. Is this the type of cost shift you worry about, or since the Postal Service is already paying into Medicare, is this merely a way to relieve pressure on its health care costs in a way that puts it on equal footing with all other employers and employees in America?

   Putting tbe postal service on equal footing and avoiding a cost shift in the federal budget are two distinct issues. Since the Medicare moneys are being paid in regardless, what matters is the spending on health care that results. If Medicare can provide equivalent benefits at a lower cost, then the shift to Medicare will still be a net improvement in the federal budget. However, if it cannot be done with efficiency gains, then the policy change improves the USPS budget, but not the federal budget elsewhere as a whole.

2. In your testimony, you point out that national health expenditure growth has been low relative to GDP growth in the past, but that it has always come back to exceed GDP growth rates, and that it may be prudent during efforts to reform the Postal Service "to plan for the risk of higher rates of growth in health care spending." From this standpoint, do you think that it is important to prefund health care benefits? If so, why?

   If the federal government guarantees a benefit, it should budget in order to provide that benefit. Pre-funding is one way to do so, and has the added advantage that it imposes the cost of financing at the time the benefit is incurred (but not yet paid). Full pre-funding is probably neither necessary nor politically feasible (no federal pre-funding has ever occurred on a large scale). However, as with the current revenues, the USPS may experience reduced mail volume in the future and have less-than-anticipated revenues. In these circumstances, some pre-funding is a sound strategy.

   The private sector has more flexibility in what they offer and how they structure employees' compensation packages. Since the USPS has to get Congressional approval in order to alter the business plan, it doesn't have that flexibility.

3. In your testimony, you discuss the reality that health care costs are increasing faster than the Postal Service can raise its prices. Given the vastly diminished role of the letter monopoly, shouldn't the Postal Service have greater control to set its own prices?

   The combination of capped mail prices, current compensation levels, and a self-funding USPS is not working. Something needs to change, and control over prices is something that other businesses exploit. If the Committee decides that compensation levels need to stay the same and the USPS must continue to be self-sustaining than yes, it will be not just desirable, but necessary, to adjust prices.