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# 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

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THURSDAY, APRIL 19, 2007



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## APPENDIX

# THE ROAD AHEAD: IMPLEMENTING POSTAL REFORM

**Thursday, April 19, 2007**

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

The Subcommittee met, pursuant to notice, at 2:30 p.m., in room 342, Dirksen Senate Office Building, Hon. Thomas R. Carper, Chairman of the Subcommittee, presiding.

Present: Senators Carper, Akaka, Coburn, Collins, and Stevens.

## OPENING STATEMENT OF SENATOR CARPER

Senator CARPER. We ask the Subcommittee to come to order. I would like to begin by thanking each of our panelists for being here today and for all the folks in the audience and those that aren't here who have worked with a bunch of us over the last, for me, 6 years, for others, as long as 10 years to update and attempt to make the first really major change in our postal system since Senator Stevens and his colleagues some 37 years ago worked to separate the U.S. Postal Department from where it was to bring it into, at that time, really into the 20th Century, and what we are endeavoring to do is to bring it into the 21st Century. I am proud of what we were able to accomplish and I am grateful to all who have played a role in its passage.

I really want to thank Senator Stevens. One of the first meetings I had as a new Senator—I don't know if you remember it, but we had breakfast together and we talked about how you worked to develop consensus all those many years ago and I thank you for that counsel and certainly for your support as we tried to improve on your work today.

As I have noted a number of times in the past, one of the first hearings that I attended of this Subcommittee some 6 years ago was about the Postal Service's dire financial situation. I believe the Postal Service was nearing, at the time, its statutory borrowing limit and appeared to be close to financial collapse. Things have improved remarkably, thank goodness, since then, and under the leadership of Postmaster General Potter, the Postal Service has survived September 11, 2001, survived anthrax attacks, and is currently on sound financial footing.

Setting aside a one-time charge relating to a provision in the postal reform bill, financial data released in early February show that revenue at the Postal Service was up by a little more than 6 percent in the first quarter of fiscal year 2007, and there is also another increase in productivity.

These numbers are, I think, emblematic of the leadership that Mr. Potter and his management team have shown. But they also mask some serious long-term problems that threaten the viability of the Postal Service as we know it.

As we are all certainly aware, the Postal Service must compete these days with cell phones, compete with e-mails, compete with fax machines and electronic bill payment technology. Mail volume in some areas, particularly First Class mail, has been declining in recent years, although I understand it was flat for the most recent year. In many cases, letter carriers are bringing fewer pieces of mail to the homes or businesses they visit each day. At the same time, the number of delivery points on the postal network, as we know, is still increasing by, I am told, some one million per year.

Many observers have been saying for years that the Postal Service, due to the cost of its obligation to provide universal service, was entering a so-called death spiral of declining volume, leading to higher rates, leading to more declines in volume and yet still higher rates.

The legislation that we enacted at the end of last year was intended to prevent or at least to slow this decline. We clearly could not outlaw e-mail or electronic bill payment in the legislation, but what we could do and what I believe we did do is to provide the Postal Service with more of the tools necessary to compete in a modern economy.

Up until now, the Postal Service has been operating under a business model created by Senator Stevens and his colleagues some 37 years ago, a model that worked remarkably well. In order, though, to change its prices, postal management was forced to go through a ratemaking process that often took more than a year to complete, and at the end of the day, the Postal Service was given little incentive through that rate system to modernize its organization and modernize its operations because they were essentially entitled to receive whatever price increases they needed to cover their costs, whatever those costs might be.

Well, that will soon no longer be the case. Under the rate system currently being developed by the Postal Regulatory Commission (PRC), the Postal Service will have significantly more freedom to price their products according to what the market will bear and tailor prices to the needs and demands of their customers. It will also be forced to live for at least 10 years under a tight rate cap based on the Consumer Price Index that will force the continuation of the streamlining process that was begun under the Postmaster General.

At the same time, the bill signed into law last December strengthened management and transparency at the Postal Service and it gave the Postal Regulatory Commission significant new authority to ensure that the Postal Service is complying with applicable laws and regulations. And the authority of the Commission will extend for the first time to service in addition to rates.

The bill also looks to the future, requiring the Postal Service to come up with long-term goals for the right-sizing of its workforce and facilities network, and for the deployment of cheaper, more customer-friendly retail options. It also requires regular reports on the Postal Service's future. This will include recommendations on changes to the universal service obligation and the postal monopoly that are needed to ensure that those who depend on the Postal Service are getting the service that they need.

And finally, the bill seeks to shore up the Postal Service's finances for years to come. Over the next 10 years, the Postal Service will be making aggressive payments toward paying down its more than $50 billion retiree health care liability, and at the end of this period, the Postal Service will have full use of billions of dollars every year that they had been paying first into the old Civil Service Retirement System Pension Program, and then for the last couple of years into an escrow account. This money will give the Postal Service the ability to maintain rate stability and continue carrying out its universal service obligation in the future when the use of electronic forms of communication can only be expected to grow.

Starting today, it is the job of this Subcommittee to make sure that postal reform is implemented properly. In addition to hearing testimony about the current state of the Postal Service, I want us to closely examine some key provisions of the bill and the plans in place to carry them out.

Mr. Blair, you and your team at the Postal Regulatory Commission certainly have your work cut out for you. You have got a number of regulations and reports that must come out in a very short period of time, as you know. We structured our bill this way not to test you, but to ensure that the Postal Service has the ability to access the significant pricing flexibility we gave them as soon as possible.

We also wanted to give postal customers as soon as possible the benefit of the predictability and the stability that the rate cap offers them. This is especially important now that the Postal Service is implementing a rate increase and there is fear out there that another increase could be just around the corner. Personally, I would rather have the next rate increase occur under the new rules, not the old rules, so I look forward to hearing from you, Mr. Blair, and I know I have read a little bit of your testimony on this point already, but hearing from you about where we are in the rulemaking process and what help you might need from us and from the Postal Service in getting this new system up and running sooner rather than later.

If I could, let me just close by noting that those of us who had a role in drafting the postal reform bill—and we have been joined by Senator Collins—I think nobody had a greater role, certainly in the Senate, than Senator Collins in drafting this compromise and helping to get it done, getting the support of the Administration.

I want to just note that those of us who had a role in drafting a postal reform bill chose not to privatize the Postal Service and not to erode in any way the service level that the Postal Service provides. I have been concerned, then, with information my staff and I have learned about in the press and from postal employees and customers about the contracting out of mail delivery. I know that the Postal Service is under tremendous pressure to streamline and to cut costs and that this pressure will only grow once the rate cap being developed is in effect. I also know that contractors have always been a part of mail delivery, always have been, probably always will be, probably always should be, and I recognize that there may be some areas where the use of contractors could be expanded.

However, I am concerned if what we are seeing now is the beginning of a rapid and wholesale transition from postal employees to contract employees in the area of mail delivery. If more mail delivery is to be contracted out, the Postal Service needs to be more open about its plans. Customers need to hear about the impact contracting decisions will have on service and employees need to know that they will be treated fairly. I, for one, would like to know some more about the process being used to solicit and review bids, and once a contract has been signed, to oversee the work done by contractors and whoever it is that they may subcontract with.

Letter carriers are often the only contact most Americans have with the Federal Government almost every day. In many cases, they are also probably the only part of the Federal Government that people have, too often, positive feelings about. I think it is important, then, that there be more openness from the Postal Service about what their plans are if contracting out of mail delivery truly is to become more common.

With that having been said, Senator Coburn, you are on.

**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.

## OPENING STATEMENT OF SENATOR AKAKA

Senator AKAKA. Thank you very much, Mr. Chairman. I am pleased to be with you here this afternoon. I want to add my welcome to the witnesses. I first want to commend my colleagues, especially you, Chairman Carper and Senator Collins, who worked tirelessly to craft a bill that will hopefully not only preserve the Postal Service, but also improve it.

I am pleased to see that the Postal Service has been taken off the GAO's high-risk list, in large part due to the passage of the Postal Accountability Enhancement Act (PAEA). One area I am particularly interested to hear about is the effort to implement the new accounting standards called for PAEA. While the Postal Service has made strides in the area of financial transparency, including quarterly reporting of data and making that data more accessible, the Postal Service will now be held to similar disclosure standards as private companies are under the Sarbanes-Oxley Act.

Another issue is the creation of new regulations that will give the Postal Service increased flexibility in responding to costs by allowing them greater latitude in setting new rates. It is my hope that the Postal Regulatory Commission will be able to write strong regulations in a timely manner. I also hope that if the final rate change case under the old system is put into motion this year, that the Commission can still work to develop these regulations as soon as possible.

I have also been made aware about issues regarding the use of contractors for delivering mail. While the Postal Service has long used contractors for extremely rural routes and for limited highway routes, we have seen an increase in the use of contractors for more urban routes. I believe there is a place for contractors in the Postal Service, but the practice should never be abused or unnecessarily expanded. Mr. Potter, I hope that you can share with us what the Postal Service is doing in this area.

Chairman Carper, again, I thank you for calling this hearing and look forward to the testimonies here and look forward to working with you on this matter. Thank you.

Senator CARPER. Senator Akaka, thanks much. Thanks for joining us today. Thanks even more for your counsel and input and that of your staff as we worked on this endeavor for the last half-dozen or so years.

I want to yield now to Senator Collins and just say, thank you so much not for just being here, but for allowing me to be your sidekick as we tried to craft this legislation and to get it done last year. Senator Collins.

## OPENING STATEMENT OF SENATOR COLLINS

Senator COLLINS. Thank you very much, Mr. Chairman. I very much appreciate the opportunity to join you today.

You know, the last postal reform bill before ours was more than 30 years ago and the author of it was Senator Stevens. This has taught me that postal reform only comes around every 30 years, and I don't know about you, but after working so hard over 3 years to get our bill passed, I think we should wait another 30 years before there is another one.

Senator CARPER. Senator, I don't plan to be around then.

Senator COLLINS. Neither do I.

Senator CARPER. Senator Stevens might be, but I will be long gone. [Laughter.]

Senator COLLINS. I would ask unanimous consent that my full statement be put in the record, but I do want to make just a few comments, if I may.

Senator CARPER. Without objection.

OPENING STATEMENT OF SENATOR COLLINS

Thank you, Mr. Chairman. I appreciate the opportunity to join you today for this very important hearing.

This Committee has invested a great deal of time and effort on the issue of postal reform. This process, which began in 2002, included numerous hearings and close consultation with the entire range of experts and stakeholders, from the managers of the United States Postal Service and employee unions to non-profit organizations and other members of the mailing community.

I was proud to stand alongside Senator Carper last December as the President signed the postal reform legislation that bears our names into law. Through the long and complex process of crafting this comprehensive modernization of the Postal Service, it became clear to us why postal reform is enacted only every 30 years.

But enacting legislation is only part of the equation. The other is implementation, and that is why we are here today. Although the issues that we confronted were many and complex, our purpose was straightforward: to position the Postal Service for the 21st Century, to ensure the affordable universal service that is essential to the American people, and to strengthen a service that is the linchpin of a $900-billion mailing industry that employs 9 million Americans in fields as diverse as direct mailing, printing, catalog production, paper manufacturing, and financial services. The health of the Postal Service is essential to the vitality of thousands of companies and the millions that they employ, as well as to the more than 750,000 postal employees.

Given the important contributions of the mailing industry to the Postal Service and our economy, I am particularly concerned by the sudden and sharp rate increases proposed by the Postal Regulatory Commission for Standard Mail flats. These proposed rates could drive smaller catalog companies out of business or at least undermine their profitability. This is exactly the kind of double-digit, unpredictable jump in rates that our reform bill was designed to prevent.

Let me illustrate the damage this proposal will cause to the catalog mailing industry with some examples from my home state of Maine. Geiger Brothers, a family business in Lewiston, is a manufacturer, supplier, and distributor of catalogs, calendars, and a wide variety of other printed materials, including the world-famous Farmer's Almanac. This company estimates this decision would cause an increase in mailing costs of 29 percent. This proposed increase would cost Geiger Brothers an additional $600,000 this year.

Another fine Maine company, Cuddledown is a nationally renown manufacturer of luxury down comforters and other high-quality bedding products with a heavy reliance on mail orders. This family-owned business, located in Portland, estimates that this proposal would increase its mailing costs by 18 percent.

I have also heard from L.L. Bean, Maine's legendary outdoor outfitter and a world leader in catalog sales, which would be negatively affected by the rate increase and may need to reduce its mailings in order to maintain postage costs at a sustainable level.

These unexpected and steep increases will cause similar harm to catalog mailing businesses throughout the nation. Not surprisingly, the comments filed in response to the proposed rates indicate that this increase will cost jobs and stifle economic growth of companies vital to communities throughout our country.

In addition to the concerns I have with the current proposed rate increase, I would strongly discourage the Postal Service from filing a "final" rate case under the old rate setting rules before postal reform is fully implemented. Filing a new rate case would divert resources and effort from developing a modern system of rate regulations as required under the new postal reform law.

I look forward to the testimony we will hear today concerning how the PRC and the Postal Service are working to ensure predictability and stability in the rate setting process and implementing other core principles of the postal reform act.µ

Thank you, Mr. Chairman.

Senator COLLINS. We are very proud of the postal reform legislation that all of us on this panel worked so hard to get signed into law last year, but enacting legislation is only part of the equation. The other is implementation and that is why I really commend the

Subcommittee Chairman for holding this hearing today and that is why we are here.

Although the issues that we confronted in enacting this legislation were many and complex, our purpose was straightforward and that was to position the Postal Service for the 21st Century to ensure that affordable universal service that is essential to the American people was continued and to strengthen a service that is the linchpin of a $900 billion mailing industry that employs some nine million Americans in diverse fields such as direct mailing, printing, catalog production, paper manufacturing, financial services—the list goes on and on.

Given the important contributions of the mailing industry to the Postal Service and to our economy, I am particularly concerned by the sudden and sharp rate increases proposed by the Postal Regulatory Commission for standard mail flats. These proposed rates could drive smaller catalog companies out of business or at least undermine their profitability. This is exactly the kind of double-digit unpredictable jump in rates that our reform bill is designed to prevent.

Let me just illustrate the damage that this proposal would cause to the catalog mailing industry with some examples from my home State of Maine. Geiger Brothers is a family-owned business in Lewiston, Maine, that is a manufacturer, supplier, and distributor of catalogs, calendars, and a wide variety of printed materials, but it is probably best known to most of you as the publisher of the famous Farmer's Almanac. This company estimates that the proposed decision would cause an increase in mailing costs of 29 percent. This proposed increase would cost this family-owned business an additional $600,000 this year.

Another fine Maine company, Cuddledown, is a nationally known manufacturer of luxury down comforters and other high-quality bedding products. It, too, has a heavy reliance on mail orders. It is essentially a catalog company. This is another family-owned business. It is located in Portland, Maine, and it estimates that the proposal would increase its mailing costs by 18 percent.

I have also heard from L.L. Bean, Maine's legendary outdoor outfitter and a world leader in catalog sales. It would be negatively affected by this sudden and substantial rate increase and tells me that they are looking at whether they need to reduce mailings in order to maintain postage costs at a sustainable level, and that is what happens when you have a sharp increase in postal rates. Then mailers look for other ways to deliver their products and that causes a decline in volume, which is the last thing we want for the Postal Service.

Not surprisingly, the comments filed in response to the proposed rates indicate that this increase would cost jobs and stifle economic growth of companies vital to communities throughout the country.

In addition to the concerns that I have with the current proposed rate increase, I want to publicly and strongly discourage the Postal Service from filing "a final rate case" under the old rate-setting rules before postal reform is fully implemented. All of us knew that this particular rate increase was going to come about, but the authors of the bill certainly hoped this would be the last one under the old system. Filing a new rate case would divert resources and efforts from developing a modern system of rate regulations as required under the new postal reform law. We did give a substantial implementation time, but frankly, we did not expect two rate filings during that time and I hope that this is the last one that we will see under the old system.

Again, I appreciate how vital the Postal Service is for our economy, for our society. You have no stronger supporter than the Members who are here today and we want to continue to work with you to ensure predictability and stability in the rate-setting process, to ensure a strong Postal Service not only for the dedicated employees of the Postal Service, but also for the Americans throughout this country who rely upon it. We hope you will work closely with us in implementing the core principles of the Postal Reform Act.

Thank you, Mr. Chairman.

Senator Stevens, I should have come to you—I apologize. I should have come to you sooner. I didn't, but we are delighted that you are here and hope that you are not disappointed with the work that we have done to carry on after you.

## OPENING STATEMENT OF SENATOR STEVENS

Senator STEVENS. I am delighted with the work that you and Senator Collins have done, there is no question about that. I am saddened that we did not get started at two o'clock, because I had hoped to hear the statements. I do have a conflict, as Senator Coburn did. I greet you all.

I understand that we have this rate increase scheduled for May 14. It will affect everyone nationwide, I am sure, but no one will be affected the way rural Alaskans will be because of bypass mail. As you all know, we are in a situation where 70 percent of the cities and villages of our State can be reached only by air, so very few people out there, Mr. Potter, know the President's name, but they all know your name. [Laughter.]

They all know the Postmaster General, and there is no question about it that this increase—for example, my staff tells me that in terms of shipment to Barrow in bypass mail, a gallon of milk will increase from $8 to $9 a gallon. You buy it at the store for, what, $1.50? A 10-pound bag of flour will increase from $11.50 to $13. That is the cost that it is going to go up on these goods and foods that my people, really our people, totally depend upon. This is the lifeline to Alaska, is the Postal Service, and these communities already pay twice as much for their necessities as the average American.

So this is something that bothers me considerably. I do hope, and as I said to the Postmaster General, I am working even today, tonight, with a group of Alaskans who are trying to suggest ways we might change the way packages are prepared and are handled so that we can take some of the costs off of the Postal Service and deliver a product to them that would reduce your costs with the hope that somehow or other those could be reflected in adjustments of the cost increases that are proposed.

We understand it costs. We understand right now some of our people are paying more than $5 a gallon for diesel fuel. We know we are all paying around $3 a gallon for gasoline; they are paying

$12. Even though we have all of that oil, it still has to be delivered in cans that you deliver through bypass mail. So this is a very important subject for us.

I would hope, Mr. Blair, that sometime you would bring the Commission back up to Alaska. They haven't been up there for about 15 years, as I recall. I think it would be good for people who inspect the Post Office to come take a look. It is a workable system, but we cannot break it down by forever increasing costs that make it impossible for the people to pay. I think we can make some suggestions to you that will alleviate this need for increasing as much as it will the cost of bypass mail in Alaska.

I appreciate your concern, and thank you, Mr. Chairman.

Senator CARPER. Thank you, Senator Stevens.

Let me just take a moment, if I could, to introduce our witnesses. We apologize for not starting at 2 o'clock. We had a vote that was called. In fact, two votes were called and we ended up having just one. Maybe when I get to be leader of our side, then we can schedule these votes at a time that is more convenient for subcommittees like this one to meet, but that hasn't come yet.

I want to just take a moment, if I can, to introduce our witnesses. Jack Potter is the 72nd Postmaster General of the United States. He assumed his current duties in June 2001, almost 30 years after going to work for the Postal Service. He started there in 1978 as a clerk and has served through the years as Chief Operating Officer, Vice President for Labor Relations, and in a number of other key posts here in Washington and out in the field. He holds a Bachelor's degree from Fordham University and a Master's from Massachusetts Institute of Technology, where my oldest son, by the way, is in his freshman year.

Dan Blair is the chairman of the newly-created Postal Regulatory Commission. Congratulations, I think. He was confirmed by the Senate as a Commissioner on the Postal Rate Commission, the predecessor agency to the Regulatory Commission, on December 6, 2006, and named as chairman by the President, no less, on December 15. Prior to coming to the Commission, Mr. Blair served as Deputy Director of the Office of Personnel Management. He also worked for 17 years here on Capitol Hill, including some time on the full Committee. How long were you on this Committee?

Mr. BLAIR. Four years.

Senator CARPER. Four years. He holds a B.A. and a J.D. from the University of Missouri at Columbia.

Kate Siggerud is a Director of the Physical Infrastructure Issues Team at the Government Accountability Office. She has directed GAO's work on postal issues for several years, including recent reports on delivery standards and performance, processing and network realignment, contracting policies, postal stamps, and biological threats. She has an M.A. in public policy from the Hubert H. Humphrey Institute of Public Affairs at the University of Minnesota and a B.A. from McCallister College.

We welcome each of you here today. We thank you for your help in crafting the legislation that we are beginning our oversight hearing on at this time. So thank you for coming, and Mr. Potter, you are the lead-off hitter.

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

Mr. POTTER. Good afternoon, Chairman Carper. I will have to get used to that now.

Senator COLLINS. So do I. [Laughter.]

Mr. POTTER. Senator Collins, Senator Akaka, and Ranking Member Senator Coburn, I am honored to be here as America's Postal Service enters a new era.

The Postal Reorganization Act of 1970 converted a heavily subsidized Post Office Department into a self-supporting Postal Service, one defined by excellent service, customer satisfaction, and productivity. Our people have done an outstanding job. Unfortunately, significant changes in the communications and delivery markets have made continued success under the original law problematic. That is why our Nation is so fortunate that so many have recognized this and acted to preserve universal affordable service to the American public.

I appreciate the extraordinary efforts of the Members of this Subcommittee. I know that we wouldn't have had that package had it not been for the leadership of Senator Collins, particularly in the financial area, and the leadership of the Chairman, Senator Akaka, Senator Stevens, everyone, Senator Carper, everyone supported this effort and it is our job to make it work. Both Houses of Congress, the Comptroller General, David Walker, the Administration, the President's Commission on the Postal Service, all made great contributions to the new law. It is my hope that 30 years from today, a future Postmaster General will sit at this table and report on the progress made possible by the Postal Accountability Enhancement Act of 2006.

Unfortunately, our business model remains broken, even with the positive pricing and product changes and all of the positive changes when it comes to employee retirement benefits that are built into the new law. With the diversion of messages and transactions to the Internet from the mail, we can no longer depend on printed volume growing at a rate sufficient to produce the revenue needed to cover the costs of an ever-expanding delivery network. This is not to say that the new law does not offer opportunities. We are in better position than ever to respond quickly to market conditions and we will operate more nimbly in the expedited and package product sectors. Growth is our greatest challenge as we shift from a transaction-based mail stream to one centered on lower-margin marketing and advertising mail.

People are also finding new uses for the mail and I am encouraged by that. For example, the State of Oregon conducts elections through the mail, resulting in greater voter participation. Not only is this encouraging from a mail point of view, but it presents a unique opportunity for our democracy.

We will continue our work with all mailers and use the latest technology to add even more value to the mail. One example is the new intelligent mail bar code. It improves quality. It cuts costs. And it increases convenience for mailers and for the Postal Service.

[1] The prepared statement of Mr. Potter appears in the Appendix on page 35.

The good news for us all is that marketers have learned that direct mail adds to the value of campaigns and that mail complements other advertising media, including the Internet. Overall, direct mail is among the fastest growing and most effective advertising channels in America today. That is why I am very bullish on the mail.

But I am also a realist. Success under the new law will not be easy. We have never worked under a fixed rate cap. We have never had to manage our costs by class of mail. Both are extremely challenging. Because we have little control over some of our major costs, such as fuel and employee retirement and health benefits, we must maintain an intense focus on managing those costs. Keeping our rates under the rate cap and being able to pay our employees a fair wage requires us to find ways to remove an additional $1 billion a year in costs from our system.

Our preferred path to staying under the rate cap is to achieve productivity targets consistent with the needed $1 billion savings. Management and the unions can and should work together to increase productivity in processing, retail, and delivery operations, thus keeping costs at or about the rate of inflation. If we do not do that, we will have created a situation that requires other actions, such as contracting out.

Since the earliest days of the American Postal Service, contractors have transported and delivered the mail safely and securely. They are screened by the Postal Inspection Service, and like career employees are subject to the legal penalties under Title 18 of the U.S. Code for criminal mishandling of the mail. Procedures governing contracting out are contained in the labor-management agreements with our unions. They are a product of the complex give-and-take that marks collective bargaining.

Let me assure you that it is not our intention to take delivery work performed by postal employees today and contract that work out. We do contract out, though, new deliveries, but only in those locations where it makes sense and in accordance with our national agreement. Ninety-four percent of new deliveries, that is homes and businesses in 2006, some 1.8 million new deliveries, today are performed by U.S. Postal Service city and rural letter carriers. I do not foresee laying off any carriers as a result of outsourcing because we are only outsourcing new deliveries, and we are only doing it on a very limited basis, and that is something I pledge not to do, not to lay anybody off. I stand ready to work with our unions to secure the future of our organization, its people, and the people we serve.

In closing, let me reiterate my sincere belief that the new postal law offers opportunities to the Postal Service and the entire mailing community to have success going forward. We will take full advantage of these opportunities in support of our historic mission of providing affordable, universal service to our Nation.

Once all the other panelists are done, I would be pleased to answer any questions that you might have, and I also have a longer version that I ask be put into the record. Thank you.

Senator CARPER. We will be happy to put that longer version in the record and thank you for summarizing your testimony.

Mr. Blair, you are next. Thanks very much.

## TESTIMONY OF HON. DAN G. BLAIR,[1] CHAIRMAN, POSTAL REGULATORY COMMISSION

Mr. BLAIR. Thank you, Mr. Chairman, Senator Collins, Senator Akaka, Members of the Subcommittee. Thank you for the chance to testify today on the operation of the new Postal Regulatory Commission and our strategy for implementation of the Postal Accountability and Enhancement Act.

I wish to particularly thank you, Chairman Carper and Senator Collins, for your unrelenting efforts on behalf of postal reform, but I would also like to thank other Members of the Subcommittee for the confidence they have shown in the Commission. I would also like to acknowledge my fellow members of the Commission in the audience today, Vice Chairman Dawn Tisdale, Commissioners Ruth Goldway, Tony Hammond, and Mark Acton.

The Act represents a profound change in our regulatory functions and significantly enhances the Commission's authority. As noted, the Postal Service will have more autonomy in setting rates, particularly for its competitive products. However, the ability to increase rates for market-dominant products will be limited ordinarily by increases in the Consumer Price Index.

To ensure transparency and accountability under this new system, the Act assigns continued oversight responsibilities to the Commission. The law provides the PRC with new enforcement tools, including subpoena power, the authority to direct the Postal Service to adjust rates and take other remedial actions, and levying fines in case of deliberate noncompliance with applicable postal laws.

The Commission is fully engaged in implementing the Act as well as completing pending business. We understand that transforming the Commission into the regulator envisioned by the reform legislation will result in changes to our organizational structure and workforce capacity. The PRC is working with an outside expert in this regard.

As you know, on February 26, 2007, the Commission rendered its recommended decision on the most recent omnibus rate case. We audited the Service's projected revenue needs and made adjustments to their initial estimates. We also made improvements in the design of rates for many postal products at the Postal Service's request to better align rates more closely with shape. Our decision relied on well-established ratemaking principles, including a reaffirmation of the principle that work sharing discounts should be limited to the amount of cost savings accrued to the Postal Service, the approach ratified by the Act.

I would like to point out that the current ratemaking laws require the Commission to design rates that encourage efficient practices by mailers and the Postal Service. This last rate case was the first fully litigated case in 7 years. Therefore, the need for rates that encourage efficiencies was greater than normal because the past two rate cases resulted from settlements that didn't focus on changes in the cost of postal operations.

On March 19, 2007, the postal governors endorsed the Commission's rate recommendations with three limited exceptions, includ-

[1] The prepared statement of Mr. Blair appears in the Appendix on page 44.

ing those for standard rate flats mail. On March 29, 2007, the Commission issued an order establishing procedures for further consideration of these issues and we invited comments from interested parties before the end of this month. Because the Commission's deliberations are ongoing, I hope you will understand that it is inappropriate for me to address them specifically at this time.

One of the most critical responsibilities the Act assigns to the Commission is the establishment of a modern system for regulating rates and classes for market-dominant postal products. We are moving quickly to develop regulations for the new ratemaking system. The Commission published an Advance Notice of Proposed Rulemaking on January 30, 2007, soliciting public comments on how the Commission can best fulfill these. The initial round of comments was due on April 6, 2007, and the reply comments are due on May 7, 2007. To date, 32 parties have submitted comments.

Creating a new regulatory framework for the establishment of a more modern rate setting system is only one of the many actions facing the Commission. The Act directs the Postal Service, in consultation with the Commission, to establish service standards for market-dominant products and assigns regulatory oversight to the Commission. The Act also directs the Postal Service and the Commission to consult on developing a plan for meeting these standards. We look forward to full consultation as envisioned by the Act with the Postal Service later this spring and summer.

A key aspect of the Commission's ongoing efforts is outreach, soliciting input from postal stakeholders, specialty mail users, and consultation with other covernment agencies, such as the Department of the Treasury, State Department, the FTC, Customs and Border Protection, the Postal Inspector General, and the GAO. Appearing before this Subcommittee today and hearing your views and concerns is a critical part of this process.

Mr. Chairman, the benchmarks established for the Commission pose some daunting challenges, and especially in light of the Postal Service's opportunity to file one last omnibus rate case under prior law. There is no question that this final rate case would divert Postal Service and Commission resources that, in my opinion, would be better devoted to developing a new system of regulatory oversight. Nevertheless, the Commission is committed to a timely performance of all of its statutory obligations and to doing so in a reasoned and balanced manner.

Mr. Chairman and Members of the Subcommittee, thank you for this opportunity to testify today. I appreciate being on the panel with the Postmaster General and with Ms. Siggerud. I ask that my written statement be included in the record and I am happy to answer questions you may have.

Senator CARPER. Thanks, Mr. Blair, and your written statement will certainly be included in its entirety in the record.

Ms. Siggerud, you are recognized. Welcome. Thank you.

**TESTIMONY OF KATHERINE SIGGERUD,[1] DIRECTOR, PHYSICAL INFRASTRUCTURE ISSUES TEAM, U.S. GOVERNMENT ACCOUNTABILITY OFFICE**

Ms. SIGGERUD. Thank you. Chairman Carper, Senator Akaka, thank you for your invitation to testify at this hearing on implementation of the Postal Accountability and Enhancement Act. To begin, I wanted to recognize the Congress's efforts, particularly yours, Chairman Carper and Senator Collins, in passing this law. It provides tools for establishing an efficient, flexible, transparent, and financially sound Postal Service, one that can more effectively operate in an increasingly competitive environment.

My remarks today will focus on, first, why we recently removed the Service's transformation efforts and outlooks from our high-risk list; second, the Service's financial condition; third, opportunities and challenges facing the Service; and finally, issues and areas for continued Congressional oversight.

First, when we placed the Service on our high-risk list in 2001, we stated that a structural transformation was needed to address the financial, operational, and human capital challenges that threaten its ability to deliver on its mission. We use this list to bring attention to issues that we think need action from the Administration and the Congress. We decided to remove the Postal Service from the high-risk list because of the significant changes that occurred.

Specifically, the Service issued a transformation plan in 2002 and demonstrated commitment to the plan by cutting costs, improving productivity, downsizing its workforce, and improving financial reporting. The 2003 law reduced the Service's payments for pension obligations, allowing it to achieve record net income, repay debt, and delay rate increases.

Elements of the 2006 postal reform law that were responsive to our concerns include, first, a framework for modernizing the ratemaking process; second, an opportunity to preserve affordable universal service by reassessing customer needs and identifying efficiencies; third, recognition of the Service's long-term financial obligations by pre-funding retiree health benefit obligations, resulting in short-term costs but long-term benefits; and fourth, enhanced transparency and accountability.

Turning now to the Service's current financial condition, it will be affected by the postal reform law and the upcoming rate increase. The law has better equipped the Postal Service to control its costs and operate in a financially sound business-like manner. It places the Service on the path to eliminating its multi-billion-dollar retiree health obligations, which in turn provides an opportunity to better position the Service financially in the long term.

Changes to the Postal Service finances this year besides the prefunding of retiree health and transferring responsibility for military pensions include expensing escrowed funds and eliminating future escrow payments and eliminating certain pension funding requirements. The Service expects to lose $5.2 billion this year, largely due to the one-time expensing of $3 billion escrowed last year and then transferred this year to the Retiree Health Benefit Fund

[1] The prepared statement of Ms. Siggerud appears in the Appendix on page 51.

and the additional contribution to this fund the Service must make. The Service plans to borrow $1.8 billion, $600 million more than it had originally planned for this year. Nevertheless, other expenses and revenues have closely tracked projections. Factors that could still affect the Service's finances this year are the impact of rate increases on mail volumes, changes in fuel prices, and the resolution of labor agreements.

Although we removed the Service from our high-risk list, there are continuing and new challenges. These include generating sufficient revenues to cover costs as the mail makes changes; controlling costs, particularly for compensation and long-term health benefits; and improving productivity while operating under the price cap structure; promoting the value of mail by providing affordable, quality service and establishing mechanisms to measure and report on performance; providing useful and reliable financial data; and managing the Service's infrastructure and workforce to respond to operational needs and financial challenges.

The reform law provides opportunities, tools, and flexibilities to address these challenges. A series of new regulations, frameworks, and studies over the next few years for both the PRC and the Service will be key to implementing the law.

Finally, with regard to potential areas of Congressional oversight, two particularly important areas are: Ensuring the Service's future financial condition remains sound; and ensuring that the new legal and regulatory requirements are carried out in accordance with the intent of the postal reform law.

Other areas that warrant continued monitoring include: First, the impact of the upcoming rate increases on mail volumes, mailers, and the Service's financial condition; second, actions by the PRC and the Service to establish a new price-setting framework; third, the Service's ability to operate under a price cap while some of its cost segments are increasing above the rate of inflation; fourth, actions to establish modern service standards, monitor delivery performance, and the Service's plan for meeting those standards; and finally, the Service's ability to provide high-quality delivery service as it takes actions to deliver costs and realign its infrastructure.

Successful transformation of the Postal Service will depend heavily upon the innovative leadership by the Postmaster General and the Chairman of the PRC and their ability to work effectively with employee organizations, employees, the mailing industry, Congress, and the general public.

Mr. Chairman, this concludes my statement. I am happy to answer any questions from the Subcommittee.

Senator CARPER. Thanks, Ms. Siggerud. I am going to ask the first question of you, and just give me a fairly short answer, if you would, and then I am going to go to Mr. Blair with some questions regarding how quickly he and his team might be able to put the new ratemaking process into place.

Ms. Siggerud, I think it was about 6 years ago that David Walker, the Comptroller General, sat, I think here, and talked about the Postal Service being a high risk. Two or 3 months ago, there was good news that GAO has taken the Postal Service off the high-risk list. Why were they put on? Why were they taken off?

Ms. SIGGERUD. Sure. Let me give you a couple of answers to that. Let me re-mention the reasons that we typically put agencies on the high-risk list. That is because there are a number of indicators which are giving us concern which we feel can be addressed through Administration and Congressional action.

At that time, there was a very high level of debt, reduced capital investment, flat productivity, and the changes in the mail mix that we have all mentioned today that were threatening continued revenue. We also did not see in place a plan to deal with those very significant challenges to the Postal Service's continued financial health and operations.

Since we put the Postal Service's outlook on the high-risk list, we have seen significant action both from the Postal Service and from the Congress in dealing with these issues. We felt it was important to recognize that in taking the Postal Service off.

Second, on all of the indicators that I mentioned that were underlying causes, we saw progress on all of those in the 6 years since we put the Postal Service on that list. We thought it was time to recognize that progress and the actions by the Service and the Congress and to recognize that and to take them off the list.

Senator CARPER. Thank you. Mr. Blair, I think Senator Collins and I both touched on this and if I don't ask it, she will. She might ask it anyway. As we both mentioned in our opening statements, I would prefer that the next rate case, whenever it needs to happen, happen under the new rate system rather than under the old one. The determining factor in whether or not that happens will be how long it takes for you and your staff to issue the regulations implementing the new rate system.

The legislation enacted gave you, I think, 18 months from December to put that new system in place, and I understand there has been discussion around the possibility of a final roll-out happening much sooner.

Let me just ask to share with us your time line, and what you need from us and from the Postal Service in the coming weeks and months in order to get the new rate system up and running as quickly as possible.

Mr. BLAIR. Thank you, Mr. Chairman. I appreciate the interest in this. You are right that we think it might be a better idea to focus our resources on getting the new system up and running than working on a rate case under the old system. But we will do whatever it takes and we will do what is required of us under the law.

We were very proactive from the beginning and in January put out that Advanced Notice of Proposed Rulemaking. We were pleased to see 32 unique comments come into the Commission. We have gone through those and we are waiting for the reply comments at this point. Some have said they think it is a good idea to get it up and running sooner. Others have come back and said, they think we need to wait a little bit longer just because they want to make sure that we think fully through the regulatory structure.

Over the next few weeks, and I say few weeks—I used to have the luxury of saying months, now I say the next few weeks—we will make some decisions on how we are going to proceed. I have had good discussions thus far with the Postmaster General. We have highlighted some areas for potential discussion, including transition issues, at what point do we have a rate date each year, and I think those are all going to be helpful as we proceed to getting a new regulatory system in place.

At the summit that was held last month, I threw out the idea of getting a framework in place by October. I stand by this. I think it would be a good idea, and I know that the Postmaster General on Tuesday, before your House counterpart, said he wanted to get a better idea of what that system would look like. I think that is fair, and so within the next few days and weeks, we will be having further discussions as to what that system will hopefully look like. We can hopefully be able to have a better idea sometime this summer on what the timing for this will be, if it is going to be this October or if it is going to take the full 18 months.

Senator CARPER. Alright. Let me just reiterate again, I appreciate the need to receive input from a number of different interested parties. I am glad you have done that and am glad they have shared their comments with you. I just really do hope that the next rate case, whenever it needs to happen, happens under the new rate system rather than the old and I would ask that you and your colleagues take that to heart.

Mr. BLAIR. We will, and that is why we would like to get it done sooner rather than later. I would note that decisional filing isn't mine, so we will have to wait and see on that. But I think that your sentiments expressed are good ones and that is why you enacted a new system. You didn't want to see the kind of jumps in rates that we saw in the last case, and I think it is a good idea to get the new system up and running.

Senator CARPER. And in case I failed to mention it, let me just say that I personally prefer that the next rate case—no, I have said it enough. You get the message. Thank you.

Let me ask a question, if I could, of Mr. Potter, and Ms. Siggerud, I may ask you to comment as well. I think you have already commented on this to some extent, so I probably won't ask you to comment. But Mr. Potter, it was in a little bit of discussion in some of the statements here and some of what you all have testified to on this front, but I just want to come back and close the loop on it.

I think in the early part of February, I am not sure what the date was, but Postal Service, you were good enough to call me, I suspect you called Senator Collins and others, but the Postal Service issued a press release announcing that you reported a $2.7 billion loss in the first quarter of fiscal year 2007 and the Postal Service was projecting, I think, about a $5 billion loss by the end of the current fiscal year. I understood from that conversation and what I have heard since that these losses are due largely, maybe entirely, to an accounting anomaly brought on by the enactment of the postal reform bill late last year and your actual financial results for the first quarter were actually pretty good. I am told they were in line with your plans. I believe the Postal Service may have actually had about a $1.2 billion budget surplus if you take out those sort of one-time anomalies.

Let me just ask you again to take a minute to explain to us, why has the Postal Service had to report such a loss of that magnitude.

Mr. POTTER. Senator, last year under the old law, Public Law 108–18, the Postal Service was required to hold about $3 billion in a restricted cash fund and that was held and we had $3 billion in cash ready to pay in whatever direction we were directed by the Houses of Congress. This year, once the law was enacted, that $3 billion that we had as restricted cash became an expense, as well as the monies that we planned to set aside this year for an escrow fund. So where we had planned to have at the end of fiscal year 2007 about $6.2 billion in restricted cash on the books, that $6.2 billion became an expense.

And so as I said to you on the phone and I also had a conversation with Senator Collins and Comptroller David Walker, that although there was an accounting change and we had to conform to Generally Accepted Accounting Principles, in terms of our cash flow there was no change and that the Postal Service was still in a very favorable cash position and that we would have to incur some debt as a result of it. It was a very awkward situation. You are sitting with restricted cash. How do you approach a rate case without that cash being defined as to what you are going to expend it on.

So it is strictly a matter of the transition from the old law to the new law with the added complexity of Public Law 108–18, which gave us relief from overpayment of CSRS for 3 years after which we had to put money into an escrow account. So again, from a cash flow standpoint, we are sound and we will work hard to try and pay down that $4.1 billion in debt in the years going forward.

Senator CARPER. Alright. Thanks very much. My time has expired. Senator Collins.

Senator COLLINS. Thank you, Mr. Chairman.

Mr. Blair, there obviously is a substantial difference between what the Postal Service asked for or recommended for rates in the flats and catalogs category versus what the PRC decided. I realize there is a limit to what you can tell us today and I am not trying to cross that line, but it would be helpful for us to know generally to what extent does the PRC take into account rate shock? In other words, do you look at what the impact of a rate increase is going to be on a specific segment of the mailing community?

Mr. BLAIR. That is a good question and I think I can answer that without giving my general counsel too much heartburn. We do look at rate shock. It is one of the factors that we balance in deciding how much of a rate increase will be decided. We look at the attributable costs of the subclasses. We assign this attributable cost to the subclass. We divvy up the institutional costs. But we also look at—there are certain factors in the Act that can help mitigate and one of those is rate shock. Others that would be considered would be whether rates are properly aligned with costs and the extent to which the rates are fair and equitable.

In this specific case, I would just urge the Subcommittee to consider that these proposed rate increases came on the heels of two settled cases over the course of the last 7 years. The settled cases produced some across-the-board increases and were not the result of the fully litigated case that this last rate recommendation came under. Because of these settled cases, some mailers benefited and were insulated somewhat from higher rates than they would have received had those cases been fully litigated. What happened this time was we had a fully litigated rate case in which the rates were intended to be more fully aligned with costs.

The Postal Service came to us and proposed rates that were shape-based, meaning that the shape of the mail actually has costs causing attributes and those were recognized in the regulations. The bottom line is that we attempted to align the rates with the costs. We understand that these are high increases and may be a heavy burden for some mailers. The governors have asked us to reconsider and that is the process in which we are in.

I hope I shed a little bit of light on what the Commission's thought processes were along those lines.

Senator COLLINS. And what is the process from here on for this particular case? You have made your decision. The Board of Governors has given you its judgment. It asked you to take a second look at three elements, I believe. So what happens now? What is the time line?

Mr. BLAIR. The governors have asked us to reconsider our recommendations. I think the first two items that they asked us to reconsider, we can dispatch pretty quickly. But this one, we have asked the parties to comment. A coalition of catalog mailers has asked to reopen the record. They asked to do this last week and we gave interested parties an opportunity to file reply comments until the end of today. We will take those into account and we will be making our decision over the course of the next few days, if not this week, whether or not to reopen the record.

At that point, even if we don't reopen the record, we will still be asking parties to submit their briefs, reexamining the old record to see what we could find and cull from that that might benefit the parties involved. A number of interested parties have commented thus far. We have heard from the catalog folks. We have also heard from other flats mailers. We have heard from other mailers, as well, and so this is proving to draw quite a bit of interest.

Senator COLLINS. Thank you. Mr. Potter, I want to switch issues and bring to your attention an issue that the Maine Postmasters have brought to my attention, and that is some of your local postal managers believe that they are not being given the opportunity to adequately staff carrier routes and window positions. Front-line managers are communicating to us that inadequate staffing is, in turn, hurting their ability to provide the kinds of first-rate service that all of us want to see. I don't know whether you get the Pine Cone Postmaster publication. If not, you should. But this is the monthly periodical that is published by the Maine Postmasters and the cover story talks about this problem.

First, let me ask you, are you aware of concerns about inadequate staffing at postal windows at post offices and also on carrier routes?

Mr. POTTER. The Postmaster organizations have brought to my attention concerns about, not on a national level because statistically on a national level, we have sufficient staffing for carriers, but on a site-specific basis, they have brought that to my attention. They have also brought to my attention that in some cases staffing is a concern and is causing stress in the workplace. I have asked them to bring that back to me and let me know where that exists, because I very much want to deal with that right away.

In addition to that, I have asked the folks at headquarters to do a review from the top down, because we have the data on all these post offices, to make sure that we have sufficient staffing per route, and we are in the process of going through that. Unfortunately, I can't be everywhere, nor can the people at headquarters, so in some cases, people in the field substitute their judgment for ours about what an appropriate staffing level is and we have to address them when they are brought to our attention or when in the process of analysis we find out that somebody has been shortsighted in terms of their hiring plans.

We do have other issues, though, Senator, where we have attendance issues and we have people on light and limited duty and places where we have to use casual or non-career workers, according to the contract, to cover those jobs. In some cases, people aren't quick enough to make that happen. For example, if somebody goes and is called back to service, to serve in Iraq, we can't fill their job on a permanent basis. We have to hold it, and so there were some issues around that, as well.

So we are addressing them and we are working with our Postmaster organization, as I have said. We have asked them to bring specifics to our attention so that we can address their concerns, not only with staffing, but as well as any kind of workplace climate issues that they perceive.

Senator COLLINS. That brings me to the last issue, and let me just touch on it very quickly because my time has expired, if I may, Mr. Chairman.

Senator CARPER. Certainly.

Senator COLLINS. I toured Maine's new processing plant in Scarborough recently and I know you have been there, as well. It is an absolutely beautiful plant. But I did hear from some of the employees continued concerns again about staffing, about schedules, and I would just ask that you work with me to try to make sure that we are looking at the concerns both at the Scarborough processing plant and the concerns that the postmasters in Maine have brought to my attention. I realize you have an enormous operation and clearly you can't be everywhere at once, but I would very much appreciate your working with me to take a look at both of these concerns.

Mr. POTTER. I would be very happy to.

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

Senator CARPER. Thank you, Senator Collins. Senator Akaka, would you like to proceed?

Senator AKAKA. Thank you, Mr. Chairman.

Mr. Potter, thank you so much for your testimony. As I have indicated in my opening statement, I have had some concerns and one of them has been on contracting out. In your testimony, you mentioned that 94 percent of the deliveries are made by postal employees and that among the actions that you have taken, you said other actions could be contracting out. So let me ask you about contracting out. What are your criteria for deciding to contract out a new route or to give it to a Federal postal employee?

Mr. POTTER. Thank you, Senator. First, let me clarify. When I referenced that 94 percent, I put it in a positive way of mail being delivered by postal employees. That is of new deliveries in 2006.

Overall, I think it is a little more than 2 percent of deliveries are contracted out and they have been historically since, I think it is 1785 when the Congress directed us to do some contracting out of delivery. And so therefore, of the 97 percent, I think it is about point-five percent of all deliveries in America are done by National Rural Letter Carriers or members of the National Association of Letter Carriers.

Going forward, what we have done is we are taking a look at our challenges as described on that chart, our costs are going up and so we are looking at what is the most economical way to perform new delivery. So from a criteria standpoint, since about 2005, we have been looking at some city delivery areas, all city delivery areas, and saying where does it make sense to potentially contract out delivery, and what we have concluded is that the only place it does is if you have a body of work that would lend itself sufficiently to be sufficiently big to contract out.

So since 2005 when we began this program, we have been working very hard at it and we have contracted out a total of 18 routes, some of which have as few as 50 deliveries because they are in places that will grow to be 500 or 600 deliveries. So we are really just, in terms of National Association of Letter Carriers and big cities, we are just scratching the surface now, trying to figure out does this make sense, how would it work, and we have criteria around who we hire and how they deliver, but we are really just kind of at the infant stages of that.

In rural and suburban America, we have always used highway contract routes, particularly for those deliveries where there was a greater distance than a mile between each delivery stop, and now we have expanded that. And again, it is along the lines of new territory, where are new communities being built, and what is the most economical way to provide that level of service.

I know concerns have been raised about security and sanctity of the mail, and believe me, we are very much in tune with that. The contractors are screened by our Postal Inspection Service. They are monitored by the Postal Inspection Service. And in my experience, we have human beings doing the work, and so nobody is perfect, including our own, and so occasionally problems crop up and they are dealt with just as they are with our own employees.

Senator AKAKA. Well, as you know, we take pride in the Postal Service employees because they are Federal workers and in many cases, especially in isolated places, the only connection people have or citizens have with the Federal Government is the Postal Service employees. We want to keep this as close to that as we can.

Mr. Potter, does the Postal Service tell managers at any level whether specific routes should be filled by a contractor instead of a postal employee?

Mr. POTTER. If there is an existing route with a postal employee, they are replaced by a postal employee. The only contracting out we are doing is new territory. So if there is an established delivery route and somebody builds a building and there are 20 deliveries in that building, it goes to whatever craft currently delivers that. So if it is the NALC or the Rural Letter Carriers, it would go to that person. Again, the focus here is on new territory.

Senator AKAKA. Mr. Potter, I have heard from postal employees in Hawaii that this may not be the case. I have been told that regional managers have been told to contract out any new routes. I urge you to go back and confirm that the Postal Service is not giving specific direction in requiring contractors for new routes. That is the word that I get back and I thought I would pass it on to you.

Mr. POTTER. I appreciate that and we would be happy to share the data with you that would show you that is not the case.

Senator AKAKA. Director Siggerud, thank you for attending today. As I said in my statement, I am pleased to see the Postal Service removed from GAO's high-risk list. However, I am concerned that in the short term, the Postal Service's financial situation has taken a turn for the worse, and this, of course, was mentioned by Mr. Potter as something that concerns him. In light of this, do you believe they will be able to stay off the high-risk list?

Ms. SIGGERUD. Well, it certainly is our hope, Senator Akaka, that the Postal Service's outlook will stay off the high-risk list, but I assure you we will be in an oversight mode together with this Subcommittee to monitor the financial condition and the very significant revenue and cost challenges that Mr. Potter mentioned. I think some particular issues to keep an eye on are the debt level, for example, was one of the reasons we originally put the Postal Service on the high-risk list.

I would observe that we are in a several-year period of transition as this new rate-setting process and the new flexibilities are to be implemented and it is hard to tell exactly what the result of that will be. The Postal Service today is in a relatively good financial condition and our hope is that will be true going forward. We will be monitoring that situation.

Senator AKAKA. Thank you very much. I want to tell you, I am glad to hear that. I am sure Mr. Potter is glad to hear that, as well. Thank you very much, Mr. Chairman.

Senator CARPER. Thank you, Senator Akaka.

I would like to come back, Ms. Siggerud, to you for a question relating to productivity and then maybe to bounce that one over to Mr. Potter, as well. It is really remarkable, going back 6 years, and I said earlier when I first sat in on a hearing and we considered some of the reasons why the Postal Service was on the high-risk list and some of the challenges they faced, challenges that came across the bow, September 11, 2001, and the anthrax attacks that followed that, but it has been a remarkable turnaround. I would like to think that our legislation that we enacted late last year had some impact on the GAO's decisionmaking——

Ms. SIGGERUD. Yes.

Senator CARPER [continuing]. But a lot, frankly, occurred before that in the good work done under the leadership of Mr. Potter working with a lot of folks, the employees, the governors, the Postal Regulatory Commission, and some of the folks in this room.

Let us talk about productivity. One of the reasons why, in the eyes of this layman, you have come out of the woods to get off the high-risk is because you were able to harness the technology that had been purchased. It was put in place, but you really harnessed it, and I think you have been able to trim your workforce, I am told by close to 100,000 people. You have not fired anybody that I know of or laid people off but it has really happened through attrition. We still have very high ratings in terms of customer satisfaction. I think you are, what, 92 percent excellent, very good, or good. That is probably higher than me and most of my colleagues who work down here.

But I looked at the productivity numbers. I think one of the reasons why you made great progress is productivity, and the productivity growth that occurred. I think, again, for the last year, it slowed a bit and I would like to talk about that and focus on that a bit. Ms. Siggerud, if you could share your thoughts with us, I don't know how closely you follow that, but then to go back to Mr. Potter.

Ms. SIGGERUD. Well, Senator Carper, we certainly have followed that particular trend and I think it was somewhat harder in the last year or two for the Postal Service to achieve the type of and level of productivity increases that it had in the years previous to that. We have not looked at the specific reasons for that. I suspect that there are a fair number of low-hanging fruits in terms of work hour decreases and other types of efficiencies that were undertaken in the last 6 years and it may be difficult to continue to achieve that kind of productivity increase.

The Postal Service does plan to enter into a new round of automation in the next few years. I think it is looking to that with regard to flat sorting as another opportunity to increase efficiency and productivity. But I think that Mr. Potter may be in a better position to say exactly why there was a struggle with productivity in the last year.

Senator CARPER. Mr. Potter, should we be alarmed or concerned? As Ms. Siggerud said, maybe you have gotten the long-hanging fruit.

Mr. POTTER. That is what I always look for at first. Instead of operating under the new law—with or without the new law, operating in an environment where you have an increasing work base of deliveries and a flat or declining mail base is a problem, and we have that mail base moving to—as we have gotten more effective at delivering mail on time, people have moved down the ladder in the sense that they have moved from First Class mail to the standard rate because we have delivered it. In my opinion, one of the reasons they were able to do it is because we have improved the delivery times on that standard mail.

But when I look back at the last 5 or 6 years, I am very proud of the fact, the total fact that productivity has gone up in each and every year and I am also very proud of our employees, because when all is said and done, it was them that had to make the changes that were necessary in order to improve that productivity. And we did take advantage of automated equipment investments that had occurred in the 1990s and that continue to occur in the new century.

In addition to that, I think we have to give a lot of credit to the relationship that we have with the mailer base. Mailers have made their mail more efficient, and the way they have done that is by bar coding their mail, making it compatible with our machines, and by depositing the mail in locations upstream of origin. So they are able to do things at a more reasonable price. We have opened our systems to allow them to use that. And so this notion of least combined cost between mailers and the Postal Service, I think has also made a significant contribution.

Going forward, as Ms. Siggerud said, I think we have an opportunity to invest in equipment that will walk sequence our flat mail and make that more productive. In addition to that, I am excited about the intelligent mail bar code, and the reason I am really excited about that is because of the quality improvements that I believe we will see in mail that is being deposited into the system.

What that system will do, once we have it up and running, it will track mail from the time a mailing list is thought about, through the printing process, through the logistics process if the Postal Service is not used, to the time that mail is deposited into the system. Using an expanded bar code, one with 39 digits of information, we will have information about who sent the mail, what class of mail that was sent. We will have a unique identifier for each piece and we will have a code that tells us where it is being delivered to.

What that will enable us to do is eliminate the need to count mail when mail is deposited. It will allow us to count mail as it is being sorted. And the most exciting part from a quality standpoint, it is going to allow us to give us information—produce information that we can give back to the mailer to improve the quality of what they have put into the system.

Senator CARPER. When do you expect to have that capability?

Mr. POTTER. We have that capability today, but not on a scale that would allow everyone to do it. We have asked mailers to put that new code on beginning in 2009, but we have done test mailings today with what we thought were some very high-quality mailers. We found out that we were able to count the mail and do verification, postage statements by counting mail on automated systems, and we are also able to improve, on average, the quality of the mail base by about 7 percent.

If we put this system in place, I believe that we can drive over $1 billion worth of costs out of the system just through the implementation of this system, and I believe that we can improve the value to the sender because our systems will be totally transparent, not only ours, but the whole mailing industry system will be transparent. They will know where their mail is. It will be coded. Trays will be coded. If they put mail on pallets, it will be coded. We will have a transparent system and we will have a much more efficient and effective system and the value of product in the mailstream will go up.

So I am excited about the future. I think that we probably don't talk enough about the opportunities that are out there.

Now, in addition to that, we are seeing mailers continually moving to make their mail more efficient, not just with this new bar code, but also by making it compatible with equipment, by taking advantage of discounts that are out there. Some of the rates that were referred to earlier are a concern to us. We don't want to drive anyone out of the mail stream. We want them to think about how they could use or package their mail a little differently so that they can continue to stay in the mail.

One thing we were concerned about with the recent rates, the ones we proposed as well as some of the changes at the Rate Commission, we want to make sure that we communicate to people and the message is not to drive people out of the system, but make your mail compatible with automation and take advantage of discounts because we want everyone to stay in the mail stream.

Senator CARPER. I would like for Mr. Blair to comment. One of the responsibilities that you have in light of the new legislation is to focus on service, what we can do to make the products that the Postal Service delivers more valuable to customers. My time is expired, so I am just going to ask you to be ready, when I ask another question, to respond to that and to follow up with what Mr. Potter said.

And Mr. Potter, I want to come back to you and talk about some of the partnerships that you have begun, working with people like e–Bay. What you are doing with e–Bay, I think, is a really interesting partnership. Also, the kind of opportunities that you have maybe out in Oregon and as people vote by mail as opposed to just going to the polls. But I want to ask you to explore with us some of those new opportunities.

Senator Akaka, thank you.

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

Mr. Potter, employees at the Postal Service have contacted me about involuntary reassignments or repositioning rules that cover the assignment of displaced management and supervisory employees in downsizing situations. This, in particular, concerns me as Chairman of the Veterans Affairs Committee. These employees allege that such action is directed against veterans. They charge that these rules are a way of circumventing the prohibition on designer reductions in force. If true, such repositioning rules appear to violate the spirit of veterans' preference laws.

Can you tell me how many veterans have been subject to these repositioning rules and what rights and protections are available to veterans of the Postal Service who are subject to these repositioning rules?

Mr. POTTER. Senator, I am sorry. I don't have a specific number of people who are affected, but we can try and generate one for you. Let me just describe for you in layman's terms, because I am not a warrior and I don't know the exact verbiage, but what we are trying to do, and we are trying to live up to the spirit of OPM's efforts to place people in jobs voluntarily. So when there is a RIF, what we basically have done is allowed people to volunteer to get out from under the RIF, so that if we are moving people and they can get closer to home or they have a job that works for them, we allow them to volunteer first.

Now, unfortunately, some people have taken that, the way we are trying to do this, as a means of being anti-veteran. It is not. We are very proud employers of veterans. We have more veterans working for us than any company in America. So we are very proud of all our veterans. But when there is a need to have a reduction in force, our preference would be that we allow people to volunteer to go to other locations, and in the process of doing that, hopefully avoid a reduction in force.

And again, I believe that we are very consistent with guidelines that have been put out by OPM, and I believe in the spirit of those guidelines. I believe that we should allow people to volunteer. And again, unfortunately, I guess, some people are assuming that there is some other motivation. There is absolutely no other motivation other than to try and allow people to volunteer for assignments and give people the opportunity to do that.

Senator AKAKA. Thank you for that response.

Mr. Potter, because of Hawaii's geographic location, consumers and businesses are dependent on the U.S. Mail for many commodities, including prescription drugs. In areas of rapid growth, such as the islands of Hawaii and Maui, there are insufficient postal facilities to serve residents. On the big island of Hawaii, many residents do not have home delivery. Rather, they must pick up their mail at the post office. However, we now see that post office boxes in some areas are over-subscribed and residents must use a post office that can be up to 30 minutes from their homes. So my question to you is, what steps are being taken to address these types of problems?

Mr. POTTER. This is the first that I am hearing of that problem, so what I will do is I would rather work with you and your staff to get the specifics of it and then come back to you one-on-one and let you know what we are doing to address those specific concerns.

Senator AKAKA. I would appreciate that, Mr. Potter.

The Postal Accountability and Enhancement Act requires the Postal Service, in consultation with the Postal Regulatory Commission, to set service standards for mail products. I understand that the PRC has sat in on meetings of the Mailers Technical Advisory Committee, which is reviewing the needs of mailers. Do you view the PRC's current involvement in these meetings, attending them, as fulfilling the consultation required by the Act?

Mr. POTTER. First of all, let me speak from a Postal Service perspective and then perhaps Mr. Blair would like to speak from a Regulatory Commission standpoint.

When we are establishing—the new law says we have to reevaluate our service standards and then put measurement systems in place to measure our performance against those standards and then establish goals. The first thing we did was said, well, OK, if we are going to establish standards, then we need to reach out to the mailing community and we have the Mailers Technical Advisory Committee. We formed subcommittees around standards for different classes of mail, subcommittees of the Mailers Technical Advisory Committee, to give us some guidance on what the requirements of the mailing community are. This is not about the Postal Service, this is about the mailing community.

And as part of that effort, we invited members of the Postal Regulatory Commission to participate in that process. We want to be open and transparent around the process that we are going through and the procedures. We invite them to sit in and listen and participate in the discussions around the establishment of standards. And then as soon as that is complete, we are going to enter into a discussion around measurement systems and how that might be accomplished, and we might have differences of opinion on that, but we will, over the course of time, come to some agreement on how that should be done.

You asked a very technical question. I don't know if that fulfills the obligation for their comment. I would rather let Mr. Blair respond to that.

Senator AKAKA. Mr. Blair.

Mr. BLAIR. Thank you, Senator Akaka. I think this will probably also go to part of the question that you may be asking next, too, Mr. Chairman. Our observance on the Mailers Technical Advisory Committee is a good first start. But the legislation clearly requires consultation and we believe that a vigorous consultation and a true consultation that should take place would be a give-and-take between the two bodies, as well as hearing from the mailers. That hasn't taken place yet, not that the opportunity has been foreclosed at all. We are in the very initial stages of that.

But my discussions with the Postmaster General and with others in the community is that my view of consultation is a vigorous give-and-take here. The Postal Service clearly has the power of the pen in this, but that we would expect to see our input into subsequent drafts and into subsequent iterations of what these standards will eventually look like. We look forward to that full consultation. We have high expectations for it and we think that our initial observance on the impact is a productive prelude to these consultations.

Senator AKAKA. Mr. Blair, it sounds like the Postal Service may think this is the extent of your statutory involvement. What makes you believe that the Postal Service will collaborate with the Commission further outside of these meetings?

Mr. BLAIR. Well, I am an optimist and I think that the Postal Service and my good friend Mr. Potter will engage fully in the consultation, and I really do expect that. But I also know that this Subcommittee has high hopes for this consultative process, too, and so I know that the exercise of your oversight authority will also spur these activities forward, as well.

Senator AKAKA. Thank you, and I thank you all for your responses. Thank you, Mr. Chairman.

Senator CARPER. Thank you, Senator Akaka.

Mr. Chairman, let me come back to you and just ask you to follow up in terms of the kind of value added that Mr. Potter was talking about earlier to products. Any comments that you might have on that?

Mr. BLAIR. I think that the idea, and what I have heard so far of intelligent mail is exciting. I think it is providing value to the mail. It is providing a reason that people will continue to use the mail stream. And in moving forward on something like that, I know he said at this hearing that they have the capabilities today. The question is, at what point will the implementation be? I think that is something the Regulatory Commission, the mailing community, and this Subcommittee will have high hopes for seeing good implementation strategies. I think it is an example of giving value to a product that otherwise might not be used as heavily.

And so the ability for the Postal Service to move forward into these areas, using technology to their advantage, will hopefully stem off that red and blue on the chart—and I hope that is red and blue because I am colorblind—but the red and blue converging, or if that convergence is well out into the future.

Senator CARPER. Alright, thanks.

Mr. Potter, talk to us for a minute or two about some of the opportunities that you see. You obviously have a good one with e–Bay. The folks out in Oregon decided they would rather mail their ballots in. We have 49 other States, some territories, what kind of opportunities do you have there? And I think there are some others you probably mentioned in your written testimony that I read.

Mr. POTTER. Well, the Secretary of State from Oregon came and visited me recently in Washington, DC and he told me that he was hosting a conference of his peers this summer out in Oregon and we quickly decided we would help sponsor that event and that I would be a keynote speaker at the event because I see the value of expanding the use of the mail, particularly for elections, where it drives participation up and makes it very convenient for people to vote. I am basically out there looking for any new users and uses of the mail, and there is one that is a great example, where the Postal Service has the ability to, I think, enhance the democracy of the United States because of more ubiquity and the ease of use of using the mail.

We have worked closely with NetFlix, as an example, for the rental of DVDs, and I think if you look at the fact that their competitors are also offering a similar product, there is a case where the convenience of the mail has become a competitive advantage in that marketplace. We have opened up our network so anyone that wants the Postal Service to deliver a package the last mile is free to bring the mail to our delivery units with a parcel select product and we will take that package and deliver it the last mile.

It is interesting that, of our top four customers, three are the ones you would think of as our natural competitors because of the fact that there is an efficiency, an inherent efficiency in the rural areas to have one person who is already going there every day because of delivering letter and flat mail to also carry packages. So we are basically looking at this infrastructure that the American public has built and we are trying to figure out how we can get that infrastructure to best serve the American public.

One of the areas I would love for the Federal Government to think about is the notion of the fact that we have 37,000 retail outlets. I would hope the Federal Government would think of them having 37,000 physical locations throughout the country, and what in the future that might mean and how you might use it is something that I think we have to let our imaginations run wild here.

But we have a dilemma going forward. How do we maintain that infrastructure, and believe me, Americans love their post offices and I know that, but how do we find new sources of revenue so that we can maintain that brick-and-mortar structure going forward?

So today, we help the State Department with passports. In the future, we would like to help other Federal agencies with whatever services that they need to bring to the American public. One person came to me and said, what do you think about having a kiosk in a post office? And I said, for what? And they said, well, so that John Q. Public could come in and get in there and sit in a cubicle and talk to somebody at the Secret Service, talk to somebody at Medicare, Medicaid, or any other service that they might need to be provided by the Federal Government, and it would take some infrastructure out of the Federal Government. When you say to somebody, go to your post office, it is kind of a no-brainer. They know where their post office is. We could work something like that out.

So we are very open minded about taking the infrastructure we have, whether it is delivering hard-copy mail or packages and making sure that we have as open a system as possible for people to use it so that we can generate revenue going forward to keep universal service available to the American people, and we would also entertain anything that would make our post offices serve the government or any other function that would make a contribution to our maintenance of universal service.

Senator CARPER. Alright. Thank you. My little State of Delaware is small and a lot of times people have said, well, isn't that a disadvantage? And what we have done in my State is we have taken that disadvantage and made it our advantage. Because we are small, we are able to be responsive, turn on a dime, and think quicker and smarter, hopefully, to do any number of things.

You clearly have the opportunity to do that, as well, to take what can be a big disadvantage in that you have got this huge infrastructure, all these routes and the requirement to go to everybody's house every day or everybody's business every day, but there are advantages there and you just mentioned some ways to more fully capitalize on those advantages.

Mr. Blair, as I have mentioned, predictability and stability in rates for mailers was one of the major goals of postal reform, at least from my perspective. We did, however, include a provision in the legislation calling for the creation of a mechanism within the new rate system whereby the Postal Service may raise rates above the CPI cap that we put in place, and when we went back and forth on this exigency language, as I am sure some of you recall—I see Ann Fisher out in the audience. I am sure she recalls going back and forth on that, as does John Kilvington over my left shoulder here.

But we came up finally with language that says the Postal Service can raise rates above the CPI cap during, I think, extraordinary and exceptional circumstances. My definition of extraordinary and exceptional circumstances has been something like the September 11, 2001 attacks, a major natural disaster, or some other event that causes a significant spike in costs or drop in volume that the Postal Service really couldn't be expected to handle in the normal course of business.

Senator Collins and I laid all this out in a letter to you, Mr. Blair. Your thoughts in responding to that letter?

Mr. BLAIR. I think your sentiments speak for themselves. It is, indeed—I think that most in the postal community believe that it is a high bar for an exigency rate case. It wasn't considered to be routine. We have had a number of comments on that. I think one of the comments that the Postal Service made is that you evaluate it on a case-by-case basis. We are still evaluating all the comments, but I think those are all good in helping guide the Commission into what the procedure should be for the consideration of a case like this.

It clearly is a September 11, 2001 or anthrax-like situation. While those are not deemed to be the two cases in which it should be exercised, I think it gives us some framework for how we would consider that. I think that if you don't have a strong exigency case, it makes almost a mockery of the rate cap. So you want to make sure that, indeed, it is the rare bird case, and that while you evaluate it in my view, I would want to evaluate it on a case-by-case basis, we hopefully, during my tenure, wouldn't have to see something like that. But we will evaluate the comments, evaluate the reply comments, and come forward again. But your sentiments are appreciated.

Senator CARPER. Good. Thank you. I don't pretend to speak for Senator Collins, but in this case, I will. Both she and I appreciate the words that you have just said, your response.

I just have maybe one more question for Mr. Blair, and I will yield to Senator Akaka if he has anything further. As we have discussed a little bit here today, the Postal Regulatory Commission is currently considering, I think, three requests from the Postal Service to revise rate recommendations that you made earlier this year, and I just want to clarify for the record one point, if I may, about these rates.

If the Commission does decide to alter its initial recommendation by lowering rates in some cases and those recommendations are accepted by the Postal Service's Board of Governors, rates for other mailers may need to go up to cover the shortfall. I would ask, is that true? Will this be a factor during the Commission's consideration of the rate request?

Mr. BLAIR. Not to be unresponsive, but since this is pending litigation, I am reluctant to go into that area. Let me just speak hypothetically, however, that under the general rate regime now, with the Postal Service's revenue requests, you try to build in a rate structure in which you have rates that meet that revenue request. If you don't raise rates in one area, then you have to raise rates in another area. It is a zero-sum game.

Now, we will see what happens with the reconsideration. Again, the one party has asked that the record be reopened. New evidence may be introduced. Should that record be reopened, other parties will have the opportunity to respond, as well. So the process will play itself out.

But just to give you a flavor of what cost-of-service ratemaking is like is that it oftentimes can be a zero-sum game.

Senator CARPER. Well, this hearing has not been a zero-sum game. This has been a good hearing and this is probably not the last hearing that we will have of this nature.

We are, again, mindful of all the work that was done by so many people and organizations, some represented in this room but a lot not, and I just want to express on my behalf, and I think certainly Senator Collins, for the good work and the spirit, including the participation of the Administration, that was pivotal in adopting the legislation that we did.

I think everything that I have ever been a part of doing, I know I can always do better. We can do better and my guess is that we will certainly be able to improve on the work of the last several years and the bill that was enacted last December. One important thing for us to do from time to time is just to sit down, to invite you in to talk with us. We are mindful that there are going to be ways to improve our legislation. We don't know what they are yet. I think for the most part, we want to let this play out for a while and make, as best we can, this system work. But as we go down the line, we will find ways that we can improve on this.

I want to thank each of you for taking your time to be with us today. We thank you for your testimony. We thank you for responding to our questions. I ask that you especially remember us to Postmaster General Walker. We thank him for being present about 6 years ago when we sort of kicked this into gear and he has been a good counselor to us in the intervening years.

Ensuring that postal reform is implemented properly is real important. I will just mention this. There is a trillion-dollar mailing economy. It depends on the efficient operation of our Postal Service, so we look forward to working with our colleagues, Senators Akaka and Collins and others, and with the Postal Service and the Postal Regulatory Commission in the months and years ahead to come to make sure that this new business model turns out the way that we intended it.

The hearing record is going to stay open for 2 weeks for the submission of additional statements and questions. I just ask each of our witnesses for your cooperation in getting prompt responses to any questions that might be submitted for the record.

With that having been said, this hearing is adjourned. Thank you all so much.

[Whereupon, at 4:15 p.m., the Subcommittee was adjourned.]

# APPENDIX

UNITED STATES POSTAL SERVICE

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

**APRIL 19, 2007**

Good afternoon, Chairman Carper, Senator Coburn, and members of the Subcommittee. It is an honor and a pleasure to be here with you today as we prepare to enter a new era in the development of America's postal system.

Only four short months ago, a new and comprehensive governing statute for the United States Postal Service became law. It was the culmination of more than 10 years of effort by many of you here today, by your predecessors, by your colleagues in this body and in the United States House of Representatives, by the Administration, by the members of the President's Commission on the United States Postal Service, and by forward-looking members of the entire postal community.

It was not an easy task, but it was a necessary one. The work of a previous generation of legislators, completed 37 years ago, established the modern Postal Service and its business model – one that created the foundation for more than three decades of success in serving the people of our nation.

To make that possible, the Postal Reorganization Act of 1970 converted a heavily subsidized Post Office Department into a self-supporting Postal Service. It created a system of management and staffing based on performance, merit, and accountability, independent of partisan influence. It resulted in fair wages and career opportunity for employees at every level.

This engendered the stability that permitted the new Postal Service to anticipate, plan, and invest in the future, moving it from an organization that relied primarily on inefficient and costly manual operations, to one that is today at the cutting edge in automated mail processing technology. This has contributed to steady improvements in service performance, customer satisfaction, and productivity.

In its last full year of operation, the Post Office Department's 741,000 employees handled 85 billion pieces of mail delivered to 95 million families and businesses. Last year, roughly the same number of employees handled 213 billion pieces of mail for a delivery base of 146 million addresses. Without advances in productivity and automation, and innovations such as customer worksharing, growth in mail volume over the intervening years would have required a staff of 1,800,000 employees – with the associated growth in costs.

Consistent with its mandate to break even over time, the modern Postal Service, over the course of 36 years of progress, has matched its expenditures with its income. It has not received an operational subsidy from Congress since 1982 – a full quarter century ago. Stamp prices, on average, have tracked the Consumer Price Index since the transition from the Post Office Department to the United States Postal Service became effective, on July 1, 1971.

And, perhaps most significantly for our nation, a productive partnership and cooperation with postal customers – a relationship marked by creative responses to their needs – contributed to the creation of a vibrant mailing industry that today plays a leading role in our economy. This is a situation not found anywhere else in the world.

Unfortunately, continued success under the original law became problematic over the last several years. Revolution in the communications and delivery markets – including technologies that could not have been imagined when the 1970 legislation was enacted – have challenged us like never before.

While the pace of change will continue, our nation is fortunate that so many have recognized, understood, and acted to preserve affordable, universal postal services for the people and businesses of America.

Comptroller General David Walker was one of them. He understood that, without change, America's postal system would be in serious jeopardy. Testifying before the United States Senate six years ago, he issued a clear call for change, and described our finances and transformation efforts as high risk.

Mr. Walker's candid but fact-based assessment was instrumental to the genesis of our Transformation Plan, which was adopted in 2002, during my first year as Postmaster General. Our goal in developing the Plan was simple – to create strategies that would involve the entire organization and keep it focused on achieving steady progress in three key areas:

- Fostering growth by increasing the value of postal products and services to our customers;
- Improving operational efficiency; and,
- Enhancing our performance-based culture.

I am pleased to say we have been successful. That success is a reflection of the hard work, dedication, and professionalism of Postal Service employees in communities in every corner of the nation. They have stepped up to the challenge. They have given it their best. And they have made a difference.

Service performance, independently measured, has reached record levels – levels that some thought were impossible not so long ago. As we begin the third quarter of this fiscal year, nationwide service performance remains strong. In locations where service may not reflect national averages, we rely on our Area staff and, where necessary, headquarters resources, to work with our field managers to improve local service.

This commitment includes my personal involvement, as well. I have visited Chicago twice in the last month to assist in the achievement of the service levels that our customers expect and deserve. I can assure you that changes underway will deliver results.

Our customer satisfaction index – also independently measured – shows that 92 percent of our customers rate their experience with the Postal Service as excellent, very good, or good – commendable results for any business.

The customer experience is important to us. In fact, the respected Ponemon Institute has recognized the Postal Service as the most trusted agency of the federal government – for the third consecutive year – and among the 10 most trusted organizations – public or private – in the United States.

We are positioned to achieve an unprecedented eighth consecutive year of productivity growth. At the end of the last fiscal year, our debt was less than one-fifth of the $11 billion outstanding when we created the Transformation Plan. Reducing and restructuring our debt has taken interest costs from more than $300 million annually to only a few million dollars today. And we have reduced staffing by over 100,000 positions – without layoffs.

We have continued to improve the working environment for our employees. This is reflected, for example, in our safety programs, which include effective partnerships with the Occupational Safety and Health Administration. These have contributed to a 43 percent reduction in OSHA illnesses and injuries over the last five years. Working relationships marked by dignity and respect must begin with a workplace that protects the health and safety of our employees.

We have built on the original Transformation Plan with the implementation of our Strategic Transformation Plan 2006-2010. This is updated periodically to reflect changing market conditions, the achievement of existing Plan goals, and the addition of new ones. We fully recognize that, even with a comprehensive new postal law, it is incumbent on us to continue our pursuit of system efficiency, service improvement, cost management, and customer value, all based on the efforts of a customer-focused, performance-based culture.

When Comptroller General Walker called for postal transformation, he was also clear about the fact that the Postal Service, by its efforts alone, would be unable to fully surmount many of the challenges he identified. He also recognized that they could be overcome only in tandem with a fundamental revision of the Postal Service's basic governing statute, Title 39 of the United States Code.

By the end of last year, the seeds planted by Mr. Walker had thrived and were ready for harvest. The Postal Service had moved into phase two of its transformation efforts – with a strong record of success under its belt. And Congress had enacted the Postal Accountability and Enhancement Act, paving the way for longer-term success. The pieces were now in place for a future that would protect affordable, universal mail service for everyone in America.

With the progress and promise represented by both of these actions, the Government Accountability Office removed the Postal Service from its "high risk" list this past January. We are grateful for this recognition of the efforts of our people over the last five years. We fully appreciate our obligation to continue to bring focused, productive, and efficient management to every element of our business. And that is our continued commitment.

At the same time, we will do everything possible – both internally and in cooperation with the full range of industry stakeholders and government partners, particularly the new Postal Regulatory Commission – to implement the provisions of the new postal law efficiently and effectively.

Soon after the new law was enacted, we began to identify, plan, and manage the timelines and processes necessary for the successful and timely implementation of the provisions of the new law. We have restructured several functions to assure maximum levels of integration, cooperation, and success. Cross-functional workgroups, including representatives from finance, marketing, operations, human resources, and the law department are meeting regularly and making progress in developing the new processes, policies, and regulations necessary to implement the new law.

We have also initiated a dialogue with other federal agencies whose activities are affected by the new law. These include the new Postal Regulatory Commission, the Department of the Treasury, the Department of State, the Department of Homeland Security's Customs and Border Protection unit, the Federal Trade Commission, and the Government Accountability Office. Of course, ongoing liaison activities with both houses of Congress, particularly our authorizing and appropriations committees, are important elements of our efforts.

We have also made mailing community outreach a key part of our activities. Last month, along with the Postal Regulatory Commission, we participated in a number of events intended to provide the mailing industry with a better understanding of the new law and how it will affect them and, more importantly, listening to what the mailers need from the new law.

These activities included a symposium, sponsored by American University's School of Public Affairs, which examined key elements of the law, and a well-attended summit, which explored a wide-range of pricing, service, and process issues arising from the Act. This was a particularly valuable discussion as the Commission begins the process of drafting the regulations that will govern the new pricing regimen.

At the 2007 National Postal Forum, the leading mailing industry trade conference, senior officers of the Postal Service presented a number of sessions devoted exclusively to the new law. In addition, the Forum's opening general session, attended by more than 4,000 delegates, featured my conversation with Dan Blair, the chairman of the Postal Regulatory Commission. And, the Postal Service Board of Governors discussed the new law at a general session on the second day of the Forum and responded to questions submitted by attendees.

We are also working closely with the Mailers Technical Advisory Committee, whose membership consists of a representative cross-section of the mailing industry, on requirements arising from the new law. Most significantly, this includes the review of our service standards and the measurement systems that will support them. We believe that ultimate success in this area must take into account the needs and preferences of our customers, the costs of implementation – for mailers and for the Postal Service – and the use of compatible technologies that passively gather and report performance metrics.

The Mailers Technical Advisory Committee and the Postal Service are also hosting a Flats Symposium in May. As we prepare for the deployment of the new Flats Sequencing System, which will sort larger envelopes, magazines, and catalogs into delivery sequence, we look forward to this important conversation with mailers. While the flats sequencer will help us manage costs and bring the full advantage of automation efficiencies to this product category, it will require changes for the Postal Service and the industry. With our transition to a shape-based rate structure, rather than one that has been primarily based on weight, we believe this symposium will benefit all parties.

The new law has created a close, complex, and complementary relationship between the Postal Service and the Commission. As Chairman Blair has noted, he and I are now "connected at the hip." I look forward to working with the Commission, not only through the development of processes supporting the implementation of the new law, but on the day-to-day regulatory and oversight issues that will help to define the Commission's new role, as well.

The Postal Service has entered a period of accelerated transition. This will require flexibility, innovation, and focus to continue achieving our transformation goals within the context of the significant changes required by the new postal law. We have an enormous responsibility to do our part in achieving the law's goals of putting the Postal Service on a firm financial footing for the future and preserving universal service at affordable rates, with price increases tied to the rate of inflation.

It is my hope that some 30 years from today, a future Postmaster General will be invited to sit at this table and report on the progress that was made possible by the Postal Accountability and Enhancement Act of 2006. But, having said that, I would be remiss if I did not point out that the Act, while providing much needed flexibility in key areas such as price-setting and product differentiation, does not resolve the underlying issue of a business model that, simply put, is irrelevant to the reality of today's market, a fact recognized by the President's Commission on the United States Postal Service in its 2003 report, "Embracing the Future." Frankly, I do not believe any law, however well intended, can repair that broken model because mail volume is no longer growing at a rate sufficient to sustain the ever-expanding delivery network.

My position is not meant as criticism; rather it is an acknowledgement that the dynamics of the 21st century communications market have altered – forever – the basic assumptions of postal economics in a monopoly environment. The traditional postal monopoly, while it still exists as a matter of theory and law, particularly for what the new statute terms our "market-dominant products," does not exist in actual practice.

The explosive growth of electronic communications and an intensely competitive package delivery sector have led to the diversion of messages, transactions, and packages from the mail channel. Competition exists for every piece of mail that moves through our system. This has significantly slowed overall volume growth, with actual declines in some products, and resulted in shifts from higher-margin products to those making a lesser contribution.

In a practical sense, this means that mail volume growth can no longer match the historic trends of the last three decades and appears to be beginning to flatten. We can no longer depend on volume growing at a rate necessary to produce the revenue required to cover the costs of an ever-expanding delivery infrastructure.

This is not to say that the new law does not offer opportunities and needed relief from an overly restrictive, inflexible, lengthy, and adversarial pricing process. To the contrary, with the potential for annual rate adjustments tied to the Consumer Price Index for market-dominant products, we are in a much better position than ever to respond quickly as the market and our financial situation demand.

And with the separation of our competitive products portfolio from the market-dominant one, we will be able to operate far more nimbly in the expedited and package products sector. The new law is sensitive to the needs of the broader market and preserves the proper balance among the Postal Service and its private-sector competitors in this area in best serving customers.

Moreover, the new law does position us favorably for growth by supporting market-based pricing and making it possible to offer volume discounts. One of our greatest disappointments historically had been the reliance of other federal agencies on our competitors for package and expedited delivery services because the old law did not permit us to match their offers. Through the improvements made by the new law, we look forward to the ability to compete with others for the privilege of serving our partner federal agencies in new and better ways than had been possible in the past.

In addition, with a retail presence at 37,000 locations in communities from coast to coast, the Postal Service offers the potential for those agencies to provide convenient and cost-effective access to their programs through our facilities. For example, today we assist the Department of State by accepting over two-thirds of passport applications at almost 5,500 of our local offices.

Growth, of course, represents our greatest challenge going forward. Electronic billing and payment alternatives continue to adversely affect First-Class Mail volume, driving the transition from a transaction-based mailstream to one increasingly centered on marketing and advertising, both of which heavily rely on Standard Mail. Because of First-Class Mail's higher margins, it takes more than two pieces of Standard Mail to provide the profit contribution of each piece of First-Class Mail diverted from our system.

The good news is that marketers have learned that direct mail – whether First-Class Mail or Standard Mail – can add to the value of campaigns that also utilize other media. In this regard – and contrary to conventional wisdom – research shows that hard-copy mail and the Internet are complementary sales channels, with one increasing the effectiveness of the other.

Direct mail, particularly catalogs, increases the time consumers spend on a retail web site. It increases the likelihood they will buy. It increases the amount of merchandise they will purchase. And it increases the amount of money they will spend.

People are also finding new uses for the mail. The State of Oregon switched to mail ballots as a better way to conduct elections, resulting in far greater voter participation than in-person voting. This is an encouraging trend, and presents a unique opportunity for our democracy. It is something I will be discussing with a gathering of the secretaries of the nation's 50 states later this year.

Since a network of post roads and post riders tied 13 struggling colonies together more than 230 years ago, the Postal Service has taken great pride in helping to connect America's citizens with their government. Vote-by-mail is simply a current example of how this traditional role continues to evolve in a new century.

Mail is also at the core of the business model of some of today's most forward-looking businesses – businesses whose primary customer interfaces are the Internet and the mail. Netflix relies on the mail to distribute videos to millions of customers every year, taking advantage of the Postal Service's daily link to every home and business in the nation. This makes it quicker, easier, and more convenient than ever for busy families to enjoy current and classic movies without having to leave their homes.

Similarly, eBay, one of the fastest-growing businesses in the world, connects millions of buyers to millions of sellers, through the mail. Our productive relationship with eBay involves continued work with members of the eBay community to develop and offer service features that provide continually improved solutions to their shipping needs.

We will continue our work with all mailers, and using state-of-the-art technology, to add even more value to our products and services. One example is the new Intelligent Mail Barcode. It improves quality, cuts costs, and increases value – for mailers and for the Postal Service.

The Intelligent Mail Barcode simplifies, streamlines, and modernizes mail entry and payment procedures. It provides a window into operations as the mail moves through our system. This helps us to identify and eliminate operational bottlenecks, while it provides mailers with data that assists in planning and decision making in areas such as staffing, cash flow, inventory, marketing, and advertising. It contributes to more accurate addressing, helping to reduce the huge and unnecessary Postal Service and industry costs of undeliverable-as-addressed mail. It will also serve as the basis for providing actual service measurement data for specific mailings rather than simply sample-based aggregate system averages. Today, more than 60 mailers enjoy the benefits of the Intelligent Mail Barcode and we are continuing its expansion, anticipating full rollout in 2009.

The value of the mail goes beyond its advantage as a business driver. It is also an important part of the social fabric of our nation. We are particularly proud of our association with ADVO, Inc. and the National Center for Missing & Exploited Children through the "America's Looking for Its Missing Children" campaign. Through leads generated by the program's "Have You Seen Me?" cards, one of the most recognizable direct mail pieces in America, 144 missing children have been safely recovered.

Overall, direct mail is among the fastest-growing and most-effective advertising channels in America today. Mail gets attention. Its results are measurable. It can be targeted like no other media. That makes it more personal than any other. No other medium can tap into individual interests, or needs, like the mail. That makes it relevant. And that makes it welcome. There's nothing like it. That's why I'm bullish on the mail.

I am also a realist. I recognize that success under the new law will not be an easy lift, by any stretch of the imagination. We have never worked under a rate cap. We have never had to manage our costs by class of mail. Both are extremely challenging.

Significant portions of our costs – such as fuel, and employee retirement and health benefits – routinely exceed the Consumer Price Index. These are costs over which we have little control. While we all experienced a sense of relief as last year's stratospheric gasoline costs receded, they have begun, once again, to climb back up. With one of the largest vehicle fleets in the nation, and an infrastructure of almost 28,000 owned and leased facilities that must be powered, lighted, heated, and cooled, this is a cause of great concern for the Postal Service and for our ratepayers. For every one-cent increase in the price of gasoline, our costs rise $8 million dollars annually.

We will maintain an intense focus on managing those costs we can control. We have had great success in this area over the last several years. We have picked the low-hanging fruit. We have stretched our arms to reach even higher. Yet we must do more.

Keeping our rates under the cap and, at the same time, being able to pay our employees a fair wage, requires that we find ways to remove at least an additional $1 billion in costs each year. We believe this can be done. It will require discipline, difficult choices, and cooperation throughout the organization, as well as support from our customers, the Postal Regulatory Commission, and the Congress. But this is not about the Postal Service for its own sake; it is about our ability to preserve affordable, quality, universal mail service for all of America.

For example, we have been exploring the expanded use of contracted delivery services – one of the most cost-effective delivery modes available. This is nothing new. Since the earliest days of America's postal system, we have used contractors to move the mail safely and securely from point to point and provide box delivery along their routes.

In fact, much of the mail you receive each day – whether delivered by a city letter carrier or a rural letter carrier – has been handled by contractors providing over-the-road or air transportation. It has been paid for by a postage stamp that may have been purchased at a supermarket, convenience, stationery or greeting card store, or perhaps at a Post Office cleaned and maintained by a contracted service provider. Just as likely, postage was provided by a meter owned and leased by a private-sector provider. And you may have deposited or picked up your mail at one of almost 4,000 contract postal retail units operated by local business people in their communities. By augmenting the services we provide directly with the services provided by others, we have been able to better manage costs, improve efficiency, and provide even more convenient access for our customers.

Viewed within the totality of our business, contract delivery service represents the smallest portion of our outsourced activities – and an extremely small percentage of our overall deliveries. The Postal Service takes a number of steps in assessing contractors and subcontractors who are selected to provide mail delivery service. They undergo background checks, screening and fingerprinting. Their suitability is ultimately determined by the Postal Inspection Service, the federal law enforcement group charged with protecting the security of the mail. Any carrier – whether a Postal Service employee or a contractor – who is involved in the criminal mishandling of the mail is subject to the same criminal penalties contained in Title 18 of the United States Code.

Procedures governing contracting out, adjusting delivery routes, and protecting employees from involuntary layoffs are contained in the collective bargaining agreements with our unions. They are the product of joint negotiations, as required by Title 39 of the United States Code. This was one of the great advances of the Postal Reorganization Act of 1970 and it is a process that Congress has endorsed through its preservation in the Postal Accountability and Enhancement Act of 2006.

The collective-bargaining process is a complex exchange of positions, ideas, and proposals. Because it is a collective process, it requires both parties to consider and adjust their own priorities in the light of those of the other. Ultimately, it is intended to produce a working agreement with provisions acceptable both to management and to the labor unions – and that work for our customers. Possible violations of the resulting contract can be challenged and resolved through a multi-step grievance procedure, which includes third-party arbitration. The parties may also revisit existing contract provisions through the joint negotiation process.

We understand the concerns any labor organization would have with outsourcing. But it is not our intention to take existing work away from our letter carriers, nor is it our intention to lay off any carriers. That is something I pledge not to do.

With postage rates linked to inflation under the new postal law, contracting out remains an effective and necessary tool to help us manage costs to achieve this mandate. Yet I believe achieving productivity gains in the delivery function can limit the growth of contracted delivery work.

This is true, as well, of our mail processing and retail operations. We must have the ability to adjust our network to accommodate the changing needs of our customers, to achieve the highest return on our technology investments, and to adapt to shifts in the type of mail moving through our system. This is critical to our success.

Our ability to operate within the constraints of a rate cap requires that we achieve our productivity targets. We can choose either of two paths. Management and the unions can work together to maximize the opportunities to increase productivity in processing operations, retail, and delivery. If we do not do that, we will have created a situation that requires additional contracting out. I stand ready to work with our unions to secure the future of our organization and its people.

I am also hopeful that we will be able to reach a negotiated contract settlement with the National Association of Letter Carriers, as we have with the American Postal Workers Union and the National Postal Mail Handlers Union. While we are formally entering the interest arbitration process, I believe the parties – and the interests of our customers – are best served by an agreement reached jointly, without the need for third-party intervention. Therefore, I will continue my efforts to achieve this outcome.

Despite our progress in cost management, there has been some concern regarding the Postal Service's financial position this fiscal year, following four consecutive years of positive net income. As you know, we are projecting a loss of approximately $5.2 billion this year.

This is primarily a function of a number of related issues connected to the creation and funding of a new Postal Service Retiree Health Benefits Fund by the new postal law.

- The $3 billion in cash that the Postal Service placed in a federally mandated escrow account in Fiscal Year 2006 was designated to be placed into the Fund in the first quarter of the current fiscal year.
- Generally Accepted Accounting Principles require that the $3 billion escrow funds, which had been considered restricted assets, be reported as a Fiscal Year 2007 expense.
- While we would have preferred a 30- or 40-year amortization schedule, the new law has a flattened 10-year payment requirement into the Fund that ranges from $5.4 to $5.8 billion annually, beginning this Fiscal Year.

It's important to put this into perspective. Although it will have a multi-billion dollar impact on our reported 2007 financial results, the additional cash required is approximately $600 million.

These payment and accounting changes create a difficult financial situation in the short term; however, this will improve significantly in 2017 and beyond, when retiree health benefits should be fully funded and this payment is no longer required.

In closing, let me reiterate my sincere belief that the new postal law offers opportunities to the Postal Service and the entire mailing community. We acknowledge these opportunities do not come without added responsibilities. To take advantage of the opportunities and to fulfill the responsibilities, we will continue to improve every aspect of our business. We can do no less.

While some have asked me what might be changed in the law, I believe it is premature to consider, without sufficient experience, what – if any – revisions might be warranted. While this may be the subject of a fruitful discussion in the future, our immediate focus must be a smooth transition and implementation of the new law. I assure you that the Postal Service will do everything possible to do that successfully.

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

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Testimony of

The Honorable Dan G. Blair, Chairman

On behalf of the

Postal Regulatory Commission

Before the

U.S. Senate

Committee on Homeland Security

And Governmental Affairs

Subcommittee on Federal Financial Management,

Government Information, Federal Services,

And International Security

April 19, 2007

Chairman Carper, members of the Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security, thank you for the opportunity to provide testimony on the operation of the new Postal Regulatory Commission and our strategy for the future.

I wish to particularly thank Chairman Carper and Senator Collins for their unrelenting efforts on behalf of postal reform. I would also like to thank other members of the Subcommittee for the confidence they have shown in the Commission as demonstrated by the Postal Accountability and Enhancement Act (PAEA).

The PRC is an independent agency that has exercised regulatory oversight over the Postal Service since its creation by the Postal Reorganization Act of 1970. Primarily, that oversight has consisted of conducting public, on-the-record hearings concerning proposed rate, mail classification, major service changes, and recommending decisions for action by the postal Governors.

The Postal legislation enacted on December 20, 2006, strengthens the authority of the renamed Postal Regulatory Commission and changes the form of regulatory oversight in many respects. The Postal Service is granted more autonomy in setting rates, particularly for its competitive products. However, the Service's ability to increase rates for market-dominant products is limited ordinarily by changes in the Consumer Price Index (CPI). The law now requires the Commission to complete its review of new rates for compliance with the CPI cap within 45 days. Moreover, the PAEA streamlines the Postal Service's ability to introduce new postal products.

To counterbalance the Postal Service's enhanced autonomy in setting rates and introducing new services, the PAEA assigns continuing oversight responsibilities to the Commission. The law appropriately equips the PRC with authority to use new enforcement mechanisms. Oversight will consist mainly of information gathering, annual determinations of Postal Service compliance, consideration of complaints, and periodic reports on Commission operations. Enforcement tools include subpoena power, authority to direct the Postal Service to adjust rates and to take other remedial actions, and levying fines in cases of deliberate noncompliance with applicable postal laws.

The Commission is now fully engaged in implementing the strengthened regulatory functions assigned by the PAEA. This effort involves completing pending business under previous law, as well as developing an organization adapted to the Commission's new responsibilities.

As you know, the Commission rendered its recommended decision on the Postal Service's omnibus rate request on February 26, 2007. We audited the Postal Service's projected revenue needs and made appropriate adjustments to their initial estimates based upon subsequent Postal Service refinements of these estimates. We also recommended improvements in the design of rates for many postal products at the Postal Service's request, such as aligning rates more closely with shape, which affects processing costs. The Commission's decision relied on well-established ratemaking principles, including a definitive reaffirmation of the principle that worksharing discounts should be limited to the amount of cost savings accruing to the Postal Service – the approach ratified by the PAEA.

On March 19, 2007, the Governors of the Postal Service endorsed the Commission's rate recommendations, with three limited exceptions: rates for the Priority Mail flat rate box; for additional ounces of non-standard First-Class letters; and for Standard Rate Flats mail. On March 29, 2007, the Commission issued an Order establishing procedures for further consideration of these issues and inviting comments from interested parties before the end of this month. Because the Commission's deliberations on these topics are ongoing, I hope you will understand that it is inappropriate for me to address them specifically at this time.

Other pending business includes two mail classification proceedings, one of which concerns a Negotiated Service Agreement or NSA. To date, the Commission has completed proceedings on six proposed NSAs and approved each of them, with the exception of one that was withdrawn at the request of the Postal Service and the co-proponent. The Commission also issued an Advisory Opinion on December 19, 2006, on the Postal Service's plans for reconfiguring its mail processing and transportation networks.

One of the most critical requirements the PAEA assigns to the Postal Regulatory Commission is the establishment of a modern system for regulating rates and classes of market-dominant postal products. In order to move expeditiously toward the new ratemaking system, the Commission published an Advance Notice of Proposed Rulemaking on January 30, 2007, soliciting comments on how the Commission can best fulfill its responsibilities and achieve the objectives of the PAEA. The initial round of comments was due on April 6, 2007, and reply comments will be due on May 7, 2007. To date, the Commission has received comments from 32 parties. In addition, the Commission and the Postal Service co-sponsored a summit on meeting customer needs in a changing regulatory environment, with over 200 attendees on March 13, 2007.

The PAEA directs the Postal Service, in consultation with the PRC, to establish service standards for market-dominant products, and assigns regulatory oversight to the Commission. The Act also directs the Postal Service and the PRC to consult on developing a plan for meeting these standards, including any necessary changes to the Service's processing, transportation, delivery, and retail networks. Consequently, we will revisit these infrastructure issues in the context of service standards to be established under the PAEA. Moreover, we appreciate the opportunity for Commission personnel to observe meetings of the Mailers Technical Advisory Committee (or MTAC) to become better informed on mailers' views of their service needs. We look forward to full consultation with the Postal Service, as envisioned by the Act, later this spring and summer.

The Commission is also advancing toward performance of its auditing and reporting responsibilities under the PAEA. During the next two years, these responsibilities will require the following essential actions:

- A comprehensive review and report examining universal postal service and the postal monopoly in all regions of the United States, including an assessment of likely future needs and recommended changes;

- A review of all non-postal products offered by the Postal Service, followed by a determination whether each of them should continue, based on an assessment of public need for the service and the private sector's ability to meet any such need;

- Annual notice-and-comment proceedings followed by Commission determinations on whether any rates, fees, and service standards failed to comply with applicable requirements during the preceding year; and

- A report to the President and to the Congress on the first year of the Regulatory Commission's operations.

In furtherance of these tasks, the Commission has already begun discussions with the Departments of Treasury and State, the Federal Trade Commission, U.S. Customs and Border Protection, the Postal Service's Office of Inspector General, and the Government Accountability Office, regarding implementation of the new law.

The Commission is also moving on other fronts to meet its new regulatory responsibilities. One critical effort is organizational – adapting the Postal Rate Commission into the regulatory body envisaged in the PAEA.

With the enactment of the PAEA, the Commission will need to undergo changes in its organizational structure, workforce size and skills mix, areas of functionality and expertise, and policies and procedures. The Act outlines specific requirements that necessitate a timely and thorough analysis of the Commission's current state, and a strategic plan of action to bridge functional gaps and to meet statutory deadlines. The PRC is working with an outside expert in this regard.

The first step in this process documented the current organizational baseline through in-depth interviews with staff to gauge what competencies were required to perform their current duties. The Commission is analyzing and identifying skill gaps between the current baseline and the requirements the Act places on the PRC.

Another key component of the Commission's ongoing efforts is outreach: soliciting input from postal stakeholders, especially mail users, and consultation with other government agencies. Appearing before the Subcommittee today, and hearing your views and concerns, is an important part of this process. We are also progressing on schedule toward the appointment of the Commission's first Inspector General. I would like to note that the Commission has recently created an Office of Public Affairs and Governmental Relations to maintain contact with all postal stakeholders.

The benchmarks established for the Commission by the PAEA pose some daunting challenges, especially in light of the Postal Service's opportunity to file one last omnibus rate request under prior law. There is no question that an additional rate case would divert Postal Service and Commission resources that, in my view, would be better devoted to developing the new system of regulatory oversight. Nevertheless, the Commission is committed to timely performance of all its statutory obligations, and to doing so in a reasoned and balanced manner.

## CONCLUSION

In closing, I wish to acknowledge the dedication and commitment of my colleagues – Vice Chairman Dawn Tisdale, Commissioners Ruth Goldway, Tony Hammond, and Mark Acton.

Thank you, Mr. Chairman, on behalf of the Commission, for this opportunity to present a status report on our progress toward activating the strengthened oversight responsibilities assigned by the Postal Accountability and Enhancement Act. Your Subcommittee's attention to these matters assists us greatly in maintaining focus on issues vital to our Nation's postal system.

I will be happy to answer any questions you may have.

United States Government Accountability Office

GAO

Testimony
Before the Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security, Committee on Homeland Security and Governmental Affairs, U.S. Senate

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# U.S. POSTAL SERVICE

# Postal Reform Law Provides Opportunities to Address Postal Challenges

Statement of Katherine Siggerud, Director
Physical Infrastructure Issues

GAO
Accountability * Integrity * Reliability

GAO-07-685T

April 19, 2007

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Accountability·Integrity·Reliability

# Highlights

Highlights of GAO-07-685T, a testimony for the Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security, Senate Committee on Homeland Security and Governmental Affairs

# U.S. POSTAL SERVICE

## Postal Reform Law Provides Opportunities to Address Postal Challenges

### Why GAO Did This Study

When GAO originally placed the U.S. Postal Service's (the Service) transformation efforts and long-term outlook on its high-risk list in early 2001, it was to focus urgent attention on the Service's deteriorating financial situation. Aggressive action was needed, particularly in cutting costs, improving productivity, and enhancing financial transparency. GAO testified several times since 2001 that comprehensive postal reform legislation was needed to address the Service's unsustainable business model, which assumed that increasing mail volume would cover rising costs and mitigate rate increases. This outdated model limited its flexibility and incentives needed to realize sufficient cost savings to offset rising costs, declining First-Class Mail volumes, unfunded obligations, and an expanding delivery network. This limitation threatened the Service's ability to achieve its mission of providing affordable, high-quality universal postal services on a self-financing basis.

This testimony will focus on (1) why GAO recently removed the Service's transformation efforts and outlook from GAO's high-risk list, (2) the Service's financial condition in fiscal year 2007, (3) the opportunities and challenges facing the Service, and (4) major issues and areas for congressional oversight. This testimony is based on GAO's past work, review of the postal reform law, and updated information on the Service's financial condition.

www.gao.gov/cgi-bin/getrpt?GAO-07-685T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Katherine Siggerud at (202) 512-2834 or siggerudk@gao.gov.

### What GAO Found

Key actions by both the Service and Congress have led GAO to remove the Service's transformation efforts and long-term outlook from its high-risk list in January 2007. Specifically, the Service developed a Transformation Plan and achieved billions in cost-savings, improved productivity, downsized its workforce, and improved its financial reporting. Congress enacted a law in 2003 that reduced the Service's annual pension expenses, which enabled it to achieve record net incomes, repay debt, and delay rate increases until January 2006. Finally, as illustrated in the table, the postal reform law enacted in December 2006 provides tools and mechanisms that can be used to address key challenges facing the Service as it moves into a new regulatory and increasingly competitive environment.

The two key factors that will affect the Service's financial condition for this fiscal year are the new reform law and new postal rates that go into effect in May. The reform law increases the costs of funding retiree health benefits but provides opportunities to offset some of these cost pressures through efficiency gains and eliminating certain pension payments. For the rest of the year, Service officials do not expect significant changes from its projected expenses and revenues. Other factors, such as costs for fuel or labor resolutions varying from plan, could affect the Service's projected outcome for this fiscal year.

**Postal Reform Law Provides Opportunities to Address Challenges**

| Challenges facing the Service | Opportunities to address challenges |
|---|---|
| Generating sufficient revenues to cover costs as the mail mix is changing. | Provides price-setting flexibility and allows the Service to retain earnings. |
| Controlling costs, particularly for compensation and long-term health benefits, and improving productivity. | Encourages the Service to reduce costs and operate more efficiently in areas such as realigning its network and workforce. |
| Maintaining affordable, reliable service and establishing reliable mechanisms to measure and report service performance. | Establishes service standards and monitoring by the new Postal Regulatory Commission (PRC). |
| Providing useful and reliable financial data to assess performance. | Establishes new reporting, accounting, and ratemaking data requirements. |
| Managing its workforce to respond to operational changes. | Requires a plan with the Service's vision for realigning its infrastructure and workforce, and the resulting impacts on its workforce. |

Source: GAO.

Congress's continued oversight of the Service's transformation is critical at this time of significant changes for the Service, PRC, and mailing industry. Also, key to a successful transformation is innovative leadership by the Postmaster General and the PRC Chairman and their ability to work effectively with stakeholders to realize new opportunities provided under the postal reform law. GAO has identified key issues and areas for oversight related to implementing the reform law and new rate-setting structure, as well as other challenges to ensure the Service remains financially sound.

Chairman Carper and Members of the Subcommittee:

I am pleased to be here today to participate in this oversight hearing for the U.S. Postal Service (the Service). To begin, I want to acknowledge Congress's efforts in passing comprehensive postal reform legislation.[1] The Postal Accountability and Enhancement Act (the act) provides tools and mechanisms that can be used to establish an efficient, flexible, fair, transparent, and financially sound Postal Service—a Service that can more effectively operate in an increasingly competitive environment not anticipated under the Postal Reorganization Act of 1970. Effective collaboration among the Service, the newly established Postal Regulatory Commission (PRC), mailers, and employee organizations can help to facilitate the successful implementation of the act by achieving a greater understanding of each other's changing needs and operations, and how they correspond to the American public's need for the continued provision of affordable, high-quality postal services.[2] My remarks today will focus on (1) why we recently removed the Service's transformation efforts and outlook from GAO's high-risk list, (2) the Service's financial condition in fiscal year 2007, (3) the opportunities and challenges facing the Service, and (4) major issues and areas for continued congressional oversight.

In summary:

When we originally placed the Service's transformation efforts and long-term outlook on our high-risk list in early 2001, we stated that a structural transformation would be needed to address the growing financial, operational, and human capital challenges that threatened its mission to provide affordable, high-quality universal postal services on a self-financing basis.[3] This designation would help raise the urgency of taking actions to address these challenges before the situation escalated into a crisis where the options for action could be more limited. Since that time, key actions by both the Service and Congress have improved the Service's financial, operational, and human capital condition and outlook. Specifically, the Service's management issued a Transformation Plan in

[1]Pub. L. No. 109-435: The Postal Accountability and Enhancement Act, enacted Dec. 20, 2006.

[2]The act renames the Postal Rate Commission as the Postal Regulatory Commission. We will use the abbreviation PRC to represent both.

[3]GAO, *U.S. Postal Service: Transformation Challenges Present Significant Risks*, GAO-01-598T (Washington, D.C.: Apr. 4, 2001).

2002 that outlined steps to guide it in addressing its challenges and has demonstrated a commitment to implementing the Plan by cutting costs, improving productivity, downsizing its workforce, and improving its financial reporting. Further, a statute enacted in 2003 reduced the Service's annual pension expenses, which allowed the Service to achieve record net income, repay debt, and delay rate increases until January 2006.[4] Comprehensive postal reform legislation was enacted in December 2006 that among other factors, provides:

- a framework for modernizing the Service's rate-setting process;
- an opportunity to preserve affordable universal service by reassessing the future needs of postal customers and taking actions to increase value and efficiencies throughout the postal network—fundamental principles of functioning in a competitive environment;
- recognition of the Service's long-term financial obligations by prefunding retiree health benefit obligations, which will result in short-term cost increases for the Service, but over the long-term this action improves the fairness and balance of cost burdens for current and future ratepayers;
- for a transfer of the obligation to fund civil service pension payments attributable to past military service from postal ratepayers to taxpayers;[5] and
- enhanced transparency and accountability by requiring that the Service collect, track, and report financial and service performance information, including the creation and reporting of modern service standards.

Based on these actions, we determined that sufficient progress has been made to warrant the removal of the Service from our high-risk list in January 2007. We recognize, however, that the Service continues to face challenges to maintain its viability as it implements significant changes under the new law and will further discuss these challenges below.

The Service's financial condition for the current fiscal year has been affected by the act, which, along with the ensuing rate increase, will

[4]Pub. L. No. 108-18: Postal Civil Service Retirement System Funding Reform Act of 2003.

[5]Pub. L. No. 108-18 shifted the responsibility for funding benefits attributable to military service from taxpayers to postal ratepayers.

continue to affect its near- and long-term financial outlook. Specifically, changes to either projected or actual Postal Service payments that result from this act include:

- accelerating funding of the Service's retiree health benefit obligations,
- expensing funds previously set aside in escrow (transferring them to the Treasury) and eliminating future escrow payments,
- transferring funding for selected military service benefits back to the Treasury, and
- eliminating certain annual Civil Service Retirement System (CSRS) pension funding requirements.

Since the law was enacted, the Service has updated its expense projections for fiscal year 2007. To date, those expenses not directly impacted by the 2006 Act and its total revenues have tracked closely to budgeted estimates. For the remainder of the fiscal year, Service officials do not expect significant changes from projected expenses, and still expect to meet revenue targets—even though the rate decision approved by the PRC was different than what the Service requested.[6] These officials did acknowledge, however, that other factors could have a favorable or unfavorable impact on the Service's projected net loss for the year, such as the effect of rate increases on mail volumes, changes in fuel prices, and resolution of certain labor agreements. The Service is planning to borrow $1.8 billion this year, which will push its total outstanding debt to almost $4 billion to meet short-term cash flow needs that come at year end.

As the Service transitions to its new statutory framework in an increasingly competitive environment, it will continue to face financial, operational, and human capital challenges. Table 1 illustrates how the legislation provides opportunities to address some of these challenges.

[6]Higher postal rates for most mail classes will be implemented on May 14, 2007, including an increase in the price of a First-Class stamp from 39 to 41 cents. Rates for Periodicals (e.g., magazines, newspapers, etc.), however, will not increase until July 15, 2007, due to the need for more time to prepare for implementation by the Service and Periodical mailers. A detailed explanation of the recent rate developments are covered later in the testimony.

**Table 1: Reform Legislation Provides Opportunities to Address Continuing Challenges**

| Challenges facing the Service | Opportunities to address challenges |
|---|---|
| Generating sufficient revenues to cover costs as the mail mix is changing. | Provides price-setting flexibility and allows the Service to retain earnings. |
| Controlling costs, particularly for compensation and long-term health benefits, and improving productivity. | Encourages the Service to reduce costs and operate more efficiently in areas such as realigning its network and workforce. |
| Maintaining affordable, reliable service and establishing reliable mechanisms to measure and report service performance. | Requires the Service to establish service standards in consultation with the new Postal Regulatory Commission, which will annually report on the Service's performance against these standards. |
| Providing useful and reliable financial data to assess performance to management, regulators, and oversight bodies. | Establishes new reporting, accounting, and ratemaking data requirements. |
| Managing its workforce to respond to operational needs. | Requires a plan to describe the Service's vision for realigning its infrastructure and workforce, including the impacts of facility changes on its workforce and whether the Service has sufficient flexibility to make needed workforce changes. |

Source: GAO.

Continued oversight will be necessary to help ensure the Service's future financial condition remains sound and that the intent of the act is followed throughout implementation. In particular, we have identified major issues considered significant by various postal stakeholders, as well as areas for continued oversight including:

- the effect of the upcoming rate increases and statutory changes on the Postal Service's financial condition;
- the impact of the Service's decision on whether or not to submit a rate filing later this year under the old rate structure;
- actions by the PRC to establish a new price-setting and regulatory framework;
- the Service's ability to operate under an inflationary price cap while some of its cost segments are increasing above the rate of inflation;
- actions by the Service, in consultation with the PRC, to establish modern service standards, and the Postal Service's plan for meeting those standards;
- the Service's ability to provide high-quality delivery service as it takes actions to reduce costs and realign its infrastructure and workforce; and

- the PRC's development of appropriate accounting and reporting requirements aimed at enhancing transparency and accountability of the Service's internal data and performance results.

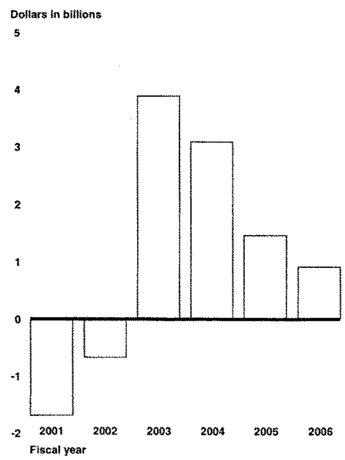
The successful transformation of the Postal Service will require innovative leadership by the Postmaster General and the Chairman of the PRC, and their ability to work effectively with their employees, the mailing industry, and the general public. We are encouraged by the Service's ongoing efforts to facilitate workgroups with participants from the mailing industry that will make recommendations regarding new service standards and measures. It will be important for all postal stakeholders to take full advantage of the unique opportunities that are currently available by providing input and working together, particularly as challenges and uncertainties will continue to threaten the Service's financial condition and outlook.

## Recent Actions Warranted the Postal Service's Removal from Our High-Risk List

Several actions—both by the Service and the Congress—led us to remove the Service's transformation efforts and long-term outlook from our high-risk list. In 2001, we made this designation because the Service's financial outlook had deteriorated significantly. The Service had a projected deficit of \$2 billion to \$3 billion, severe cash flow pressures, debt approaching the statutory borrowing limit, cost growth outpacing revenue increases, and limited productivity gains. Other challenges the Service faced included liabilities that exceeded assets by \$3 billion at the end of fiscal year 2002 major liabilities and obligations estimated at close to \$100 billion, a restructuring of the workforce due to impending retirements and operational changes, and long-standing labor-management relations problems. We raised concerns that the Service had no comprehensive plan to address its financial, operational, or human capital challenges, including its plans for reducing debt, and it did not have adequate financial reporting and transparency that would allow the public to understand changes in its financial situation. Thus, we recommended that the Service develop a comprehensive plan, in conjunction with other stakeholders, which would identify the actions needed to address its challenges and provide publicly available quarterly financial reports with sufficient information to understand the Service's current and projected financial condition. As the Service's financial difficulties continued in 2002, we concluded that the need for a comprehensive transformation of the Service was more urgent than ever and called for Congress to act on comprehensive postal reform legislation. The Service's basic business model, which assumed that rising mail volume would cover rising costs and mitigate rate increases, was outmoded as First-Class Mail volumes stagnated or deteriorated in an increasingly competitive environment.

Since 2001, the Service's financial condition has improved and it has reported positive net incomes for each of the last 4 years (see fig. 1).

**Figure 1: Recent Postal Service Net Incomes**




Source: Postal Service Annual Reports.

The Service has made significant progress in addressing some of the challenges that led to its high-risk designation. For example, the Service's management developed a Transformation Plan and has demonstrated a commitment to implementing this plan. Since our designation in 2001, the Service has:

- Reduced workhours and improved productivity: The Service has reported productivity gains in each year. According to the Service, its productivity increased by a cumulative 8.3 percent over that period, which generated $5.4 billion in cost savings. The Service reported eliminating over 170 million workhours over this period, with a 4.5 million workhour reduction in fiscal year 2006.

- Downsized its workforce: The Service has made progress in addressing some of the human capital challenges associated with its vast workforce, by managing retirements, downsizing, and expanding the use of automation. At the end of fiscal year 2006, the Service reported that it had 696,138 career employees, the lowest count since fiscal year 1993. Attrition and automation have allowed the Service to downsize its workforce by more than 95,000, or about 10 percent, since fiscal year 2001.

- Enhanced the reporting of its financial condition and outlook: The Service responded to recommendations we made regarding the lack of sufficient and timely periodic information on its financial condition and outlook that is publicly available between publications of its audited year-end financial statements by enhancing its financial reporting and providing regular updates to the financial statements on its Web site.[7] The Service instituted quarterly financial reports, expanded the discussion of financial matters in its annual report, and upgraded its Web site to include these and other reports in readily accessible file formats.

The 2003 pension act provided another key reason for why we removed the high-risk designation.[8] Much of the Service's recent financial improvement was due to the change from this law that reduced the Service's annual pension expenses. Between fiscal years 2003 and 2005, the Service had a total of $9 billion in decreased pension expenses when compared to the annual expenses that would have been paid without the statutory change. This change enabled the Service to significantly cut its costs, achieve record net incomes, repay over $11 billion of outstanding debt, and delay rate increases until January 2006.

The Service's improved financial performance and condition during this time was also aided by increased revenue generated from growing

[7]GAO-01-598T; GAO, *U.S. Postal Service: Deteriorating Financial Outlook Increases Need for Transformation*, GAO-02-355 (Washington, D.C.: Feb. 28, 2002); *U.S. Postal Service: Accounting for Postretirement Benefits*, GAO-02-916R (Washington, D.C.: Sept. 12, 2002); *U.S. Postal Service Actions to Improve Its Financial Reporting*, GAO-03-26R (Washington, D.C.: Nov. 13, 2002).

[8]The Postal Service Civil Service Retirement System Funding Reform Act of 2003 (Pub. L. No. 108-18) was enacted in response to the Office of Personnel Management's analysis, performed at our request, which concluded that the Service was on course to overfund its pension payments.

volumes of Standard Mail (primarily advertising) and rate increases in June 2002 and January 2006. Standard Mail volumes grew by almost 14 percent from fiscal year 2001 to 2006, and Standard Mail revenues, when adjusted for inflation, increased by over 11 percent during the same time period. In June 2002, the Service implemented a rate increase (the price of a First-Class stamp increased from 34 cents to 37 cents) to offset rising costs. In January 2006, the Service implemented another rate increase (the price of a First-Class stamp increased from 37 cents to 39 cents) to generate the additional revenue needed to set aside $3.0 billion in an escrow account in fiscal year 2006 as required by the 2003 pension law. Revenues in fiscal year 2006 increased by about 4 percent from the previous year due largely to the January 2006 rate increase.

The passage of the recent postal reform legislation was another reason why we removed this high-risk designation. Although noticeable improvements were being made to the Service's financial, operational, and human capital challenges, we had continued to advocate the need for comprehensive postal reform legislation.[9] After years of thorough discussion, Congress passed a comprehensive postal reform law in late December 2006 that provides tools and mechanisms that can be used to establish an efficient, flexible, fair, transparent, and financially sound Postal Service. Later in this statement, I will discuss how some specific tools and mechanisms can be used to address the continuing challenges facing the Service.

## The Postal Service's Current Financial Condition

The Service's financial condition for fiscal year 2007 has been affected by the reform act, which, along with the May change in postal rates, will continue to affect its near- and long-term financial outlook. The Service will benefit financially from an increase in postal rates in May averaging 7.6 percent. Key steps in the rate process are provided in appendix I. The Service is estimating that it will gain an additional $2.2 billion in net income in fiscal year 2007 as a result of the new rates. The recent rate case, in addition to generating additional revenues, took significant strides

[9]GAO, *U.S. Postal Service: Bold Action Needed to Continue Progress on Postal Transformation*, GAO-04-108T (Washington, D.C.: Nov. 5, 2003); *Need for Comprehensive Postal Reform*, GAO-04-455R (Washington, D.C.: Feb. 6, 2004); *U.S. Postal Service: Key Elements of Comprehensive Postal Reform*, GAO-04-397T (Washington, D.C.: Jan. 28, 2004); *U.S. Postal Service: Key Reasons for Postal Reform*, GAO-04-565T (Washington, D.C.: Mar. 23, 2004); *U.S. Postal Service: Despite Recent Progress, Postal Reform Legislation Is Still Needed*, GAO-05-453T (Washington, D.C.: Apr. 14, 2005).

in aligning postal rates with the respective mail handling costs. Some rate increases are particularly large—i.e., some catalog rates may increase by 20 to 40 percent. The new rates structure is aimed at providing the necessary incentives to encourage efficient mailing practices (e.g., shape, weight, handling, preparation, and transportation) and thereby encourage smaller rate increases and steady mail volumes in the longer run.

At the beginning of fiscal year 2007 (before the enactment of the reform law), the Service expected to earn $1.7 billion in net income, which reflected the additional revenue the Service estimated it would receive from the May increase in postal rates. The Service, however, planned to increase its outstanding debt of $2.1 billion at the end of fiscal year 2006 by an additional $1.2 billion in fiscal year 2007 in order to help fund the expected $3.3 billion escrow requirement for 2007.

Since enactment of the reform law, the Service has updated its expense projections. While the Service's total expenses for fiscal year 2007 have been affected by passage of the act, those expenses not directly related to the act and total revenues have tracked closely to plan. The Service currently is estimating an overall fiscal year 2007 net loss of $5.2 billion, largely due to changes in either projected or actual Postal Service payments as a result from the act including:

- Accelerating funding of the Service's retiree health benefit obligations: Beginning this fiscal year, the Postal Service must make the first of 10 annual payments into a newly created Postal Service Retiree Health Benefits Fund (PSRHBF) to help fund the Service's significant unfunded retiree health obligations. The 2007 payment of $5.4 billion is due to be paid by September 30. The Service has accrued half of this expense— $2.7 billion—during the first 6 months of the fiscal year and will accrue $1.35 billion in each of the remaining 2 quarters.
- One-time expensing of funds previously set aside in escrow and eliminating future escrow payments: The act requires the Service to transfer the $3.0 billion it escrowed in fiscal year 2006 to the PSRHBF, which the Service recognized as a one-time expense in the first quarter of fiscal year 2007.[10] The reform act also eliminated future escrow payments required under the 2003 pension law, including the $3.3 billion payment scheduled for fiscal year 2007.

[10]The Postal Civil Service Retirement System Funding Reform Act of 2003 required the Postal Service to escrow the reduction in its civil service pension expenses that resulted from changes to how the Service funded these pensions.

- Transferring funding for selected military service benefits back to the Treasury: The act significantly reduced the Service's civil service pension obligations by transferring responsibility for funding civilian pension benefits attributable to the military service of the Service's retirees back to the Treasury Department, where it had been prior to enactment of the 2003 pension law. The reform act requires that any overfunding attributable to the military benefits as of September 30, 2006, be transferred to the PSRHBF by June 30, 2007.[11]

- Eliminating certain annual Civil Service Retirement System (CSRS) pension funding requirements: The act eliminated the requirement that the Service fund the annual normal cost of its civil service employees and the amortization of the unfunded pension obligation that existed prior to transferring the military service obligations to the Treasury Department.[12] The Service estimates that it will save $1.5 billion in fiscal year 2007 from eliminating the annual pension funding requirements and amortization payments.

The result of these payments is a net increase in retirement-related expenses of $3.9 billion,[13] which is $600 million higher than the expected $3.3 billion escrow payment for 2007 that was eliminated. Thus, the Service is planning to borrow $600 million more than initially budgeted to cover this shortfall. This increase is anticipated to result in the Service's borrowing $1.8 billion in fiscal year 2007, which would bring its total outstanding debt to $3.9 billion by the end of the fiscal year.

The Service has identified other factors and uncertainties that, depending on how results vary from budgeted estimates, could have a favorable or unfavorable impact on the Service's projected net loss for fiscal year 2007. For example, volumes and revenues may be affected by a continued slowdown in the U.S. economy or unanticipated consequences of the recent rate decision. The Service has anticipated economic growth to pick up in the third and fourth quarters of this year, but a slowdown may depress volume growth below projected levels for the rest of the year.

[11]The Office of Personnel Management has preliminarily estimated the overfunding to be more than $16 billion.

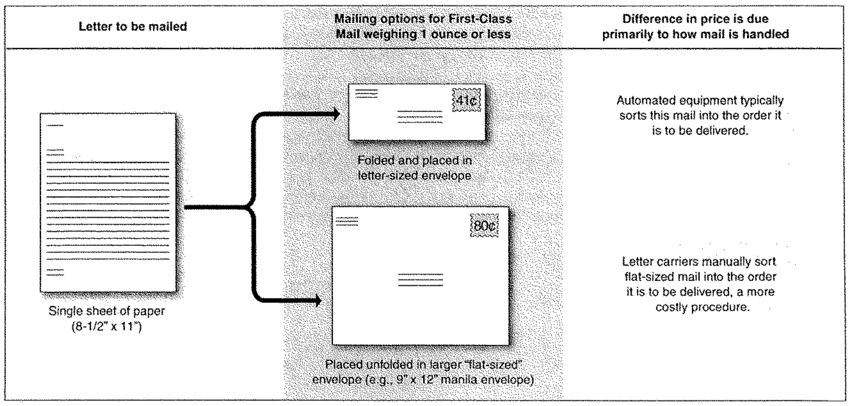
[12]The reform act delays resumption of payments from the Postal Service to liquidate any pension underfunding until September 30, 2018.

[13]The $3.9 billion net increase in retirement-related expenses is comprised of the $5.4 billion retiree health payment due to the PSRHBF by September 30, 2007, and the $1.5 billion reduction in the Service's pension expenses through fiscal year end.

Furthermore, the unusual nature of the rate case creates uncertainties for the Service that may affect its financial results. These uncertainties include how the Service and its customers will respond to the:

- limited implementation times—the 2-month implementation period (the Postal Service Board of Governors decision on March 19, 2007, stated that most new rates would become effective on May 14, 2007) leaves little time for the Service to educate the public and business mailers on the new rate changes and to allow mailers sufficient time to adjust their mailing practices and operations accordingly;
- delayed implementation times—how mailers and the Service will be affected by the delay in implementing new Periodical rates until mid-July;
- magnitude of certain restructured rates, particularly for those specific types of mail that will experience rather significant increases, and the related impact on volumes and revenues; and
- unfamiliarity with restructured rates—the prices for many popular products, such as certain types of First-Class Mail, will experience significant shifts based on the shape of the mail. For example, figure 2 shows how the cost of First-Class Mail will differ based on its shape.

Figure 2: Cost of First-Class Mail Will Differ Based on Shape of Mail under New Rate System




Source: GAO.

Moreover, the Service's expense projections may be susceptible to rising fuel prices due to the Service's vulnerability in this area or that the outstanding contract negotiations for two of its major labor unions would vary from projected levels. Although the extent to which these factors and uncertainties will affect the Service's financial condition for fiscal year 2007 is not known, they may affect its subsequent financial outlook. For example, if the Service finds that its financial performance and condition is weakening—either through revenue shortfalls or expense increases—it may decide to file another rate increase later this year.

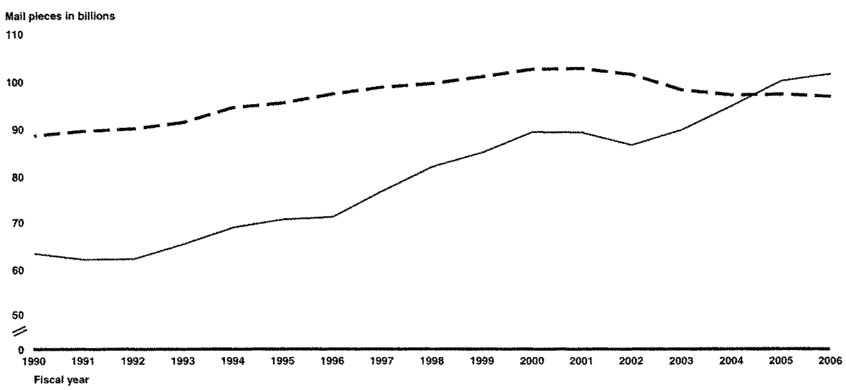
## Postal Reform Law Provides Opportunities to Address Challenges

The new postal reform law provides new opportunities to address challenges facing the Service as it continues its transformation in a more competitive environment with a variety of electronic alternatives for communications and payments. Specifically, it provides tools and mechanisms to address the challenges of generating sufficient revenues, controlling costs, maintaining service, providing reliable performance information, and managing its workforce. Effectively using these tools will be key to successfully implementing the act and addressing these challenges.

## Generating Sufficient Revenue as First-Class Mail Volume Is Declining and Mail Mix Is Changing

The Service continues to face challenges in generating sufficient revenues as First-Class Mail volume continues to decline and the mail mix changes. First-Class Mail, historically the class of mail with the largest volumes and revenues, saw volume shrink by almost 6 percent from fiscal year 2001 to 2006. The trends for First-Class Mail and Standard Mail, which currently combine for about 95 percent of mail volumes and 80 percent of revenues, experienced a historical shift in fiscal year 2005. For the first time, Standard Mail volumes exceeded those for First-Class Mail (see fig. 3).

**Figure 3: Standard Mail Volumes Are Outpacing Those for First-Class Mail**




Source: Postal Service Annual Reports.

Note: First-Class Mail volume does not include Priority Mail.

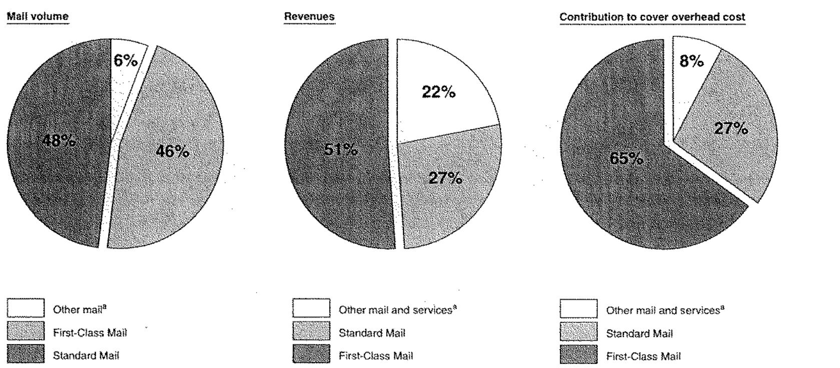
This shift has major revenue implications because:

- First-Class Mail generates the most revenue and is used to finance most of the Service's institutional (overhead) costs (see fig. 4).

- Standard Mail generates less revenue per piece compared to First-Class Mail and it takes about two pieces of Standard Mail to make the same contribution to the Service's overhead costs as one piece of First-Class Mail.

- Standard Mail is a more price-sensitive product compared to First-Class Mail because it competes with other advertising media. Also, because advertising, including Standard Mail, tends to be affected by economic cycles to a greater extent than First-Class Mail, a larger portion of the Service's mail volumes is more susceptible to economic fluctuations.

**Figure 4: Mail Volume, Revenues, and Contribution to Cover Overhead Costs, Fiscal Year 2006**




Source: Postal Service.

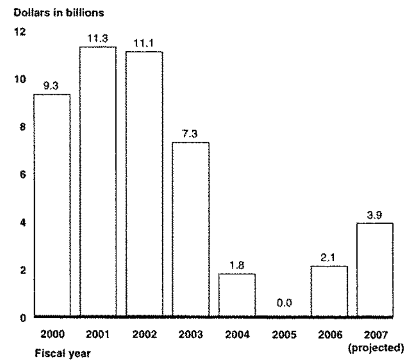
[a]Other mail includes mail such as magazines, newspapers, and parcels. Other services include postal services such as post office boxes, money orders, and delivery confirmation.

The act provides tools and mechanisms that can help address these revenue challenges by promoting revenue generation and retention of revenues. The act established flexible pricing mechanisms for the Service's competitive and market-dominant products.[14] For example, it allows the Service to raise rates for its market-dominant products, such as First-Class Mail letters, Standard Mail, and Periodicals, up to a defined price cap; exceed the price cap should extraordinary or exceptional circumstances arise; and use any unused rate authority within 5 years. For its competitive products, such as Priority Mail or Expedited Mail, the Service may raise rates as it sees fit, as long as each competitive products covers its costs and competitive products as a whole cover their attributable costs and make a contribution to overhead.

The act also allows for the Service to retain any earnings, which may promote increased financial stability. First, to the extent the Service can generate net income to retain earnings, this could enhance its ability to weather economic downturns. For example, a slow economic cycle or sudden increase in fuel prices might not necessitate an immediate rate increase if sufficient retained earnings exist to cover related shortfalls. Furthermore, to the extent the Service can retain earnings as liquid assets, it may reduce the Service's reliance on borrowing to offset cash shortfalls. The Service has stated that it will take out debt to cover cash shortfalls in fiscal year 2007 and projects that this increase will result in $3.9 billion of outstanding debt at the end of the year (see fig. 5). Controlling debt will be important because the Service needs to operate within its statutorily set borrowing limits ($3 billion in new debt each year, and $15 billion in total debt outstanding). Reducing debt was one of the key factors we cited in removing the Service's high-risk designation.

[14] Sections 201 and 202 lists which products are market-dominant and competitive.

**Figure 5: The Service Projects Nearly $4 Billion in Outstanding Debt at the End of Fiscal Year 2007**




Source: GAO analysis of Postal Service data.

Uncertainties related to the recent rate decision and reform law may impact the extent to which the Service is able to address its revenue related challenges. The uncertainties include:

- How will mailers and volume respond to the new rate decision's pricing signals?
- What types of innovative pricing methods will be allowed?
- How will the Service set rates under the new price cap system, and how will mailers respond to this additional flexibility? How will the Service and mailers be able to modify their information systems to accommodate more frequent rate increases?
- How will customer behavior change as prices change under the new system? To what extent will customers desire for mail be affected by privacy concerns, environmental concerns, preference for electronic

alternatives, or efforts to establish Do Not Mail lists?[15]

- How will the Service be able to enhance the value of its market-dominant and competitive products (e.g., predictable and consistent service, tracking and tracing capabilities, etc.)?

- What will the Service do with any retained earnings (e.g., improve its capital program, save to weather downturns in the economy)?

## Controlling Costs and Improving Productivity

The Service faces multiple cost pressures in the near- and long-term associated with the required multi-billion dollar payments into the PSRHBF, dealing with key cost categories experiencing above-inflation growth while operating under an inflationary-based price cap, and other costs associated with providing universal postal services to a growing network—one now expanding by about 2 million new addresses each year. While the reform act takes actions that increase current costs by improving the balance of retiree health benefit cost burdens between current and future ratepayers, it also eliminates other payments and provides opportunities to offset some of these costs pressures through efficiency gains that could restrain future rate increases. It will be crucial for the Service, however, to take advantage of this opportunity and achieve sustainable, realizable cost reductions and productivity improvements throughout its networks.

Personnel expenses (which include wages, employee and retiree benefits, and workers' compensation) have consistently accounted for nearly 80 percent of annual operating expenses, even though the Service has downsized its workforce by over 95,000 employees since fiscal year 2001. The Service's personnel expenses have grown at rates exceeding inflation since fiscal year 2003 and are expected to continue dominating the Service's financial condition. In particular, growth in retiree health benefit costs have, on average over the last 5 years, exceeded inflation by almost 13 percent each year. This growth is expected to continue due to (1) rising premiums, growth in the number of covered retirees and survivors, and increases in the Service's share of the premiums; and (2) the Service will continue paying the employer's share of the health insurance premiums of its retirees along with the required payments ranging from $5.4 billion to

[15]As part of the reform act, GAO is required to issue a report on the activities of the Postal Service to promote recycling and other opportunities for improvement in this area.

$5.8 billion into the PSRHBF in each of the following 9 years. While we recognize the cost pressures that will be placed on the Service as it begins prefunding its retiree health benefits obligations, we continue to believe that such action is appropriate to improve the fairness and balance of cost burdens for current and future ratepayers. Furthermore, beginning in fiscal year 2017, the Service might enjoy a significant reduction in its retiree health costs if its obligations are fully funded.

In addition to these personnel expenses, the Service has also experienced growth in its transportation costs that exceeded the rate of inflation in fiscal years 2005 and 2006. Transportation costs represent the second largest cost category behind compensation and benefits. These costs grew by about 11 percent from fiscal year 2005 to 2006, largely due to rising fuel costs. In a February 2007 report, we stated that the Service is vulnerable to fuel price fluctuations and will be challenged to control fuel costs due to its expanding delivery network and inability to use surcharges.[16]

The Service has made some progress in containing cost growth, and pledged to cut another $5 billion of costs out of its system between fiscal years 2006 and 2010 through productivity increases and operational improvements. The Service has reported productivity increases for the last 7 years, but the reported increase in fiscal year 2006 was its smallest during this period. The Service has recently had trouble absorbing gains in mail volumes while achieving targeted workhour reductions. Although the Service has reduced its workhours in 6 of the last 7 years, in fiscal year 2006, its goal was to reduce workhours by 42 million, but the Service reported a decrease of only 5 million workhours.

While both the recent rate decision and reform act seek to improve efficiencies in the postal networks, these developments will pose challenges to the Service. In terms of the rate case, the Service will be challenged to modify its mail processing and transportation networks to respond to changes in mailer behaviors (e.g., in the quantity and types of mail sent and how mail is prepared) to minimize their rates. Furthermore, the reform act provides an opportunity to address the Service's cost challenges because it requires the Service to develop a plan that, among other things, includes a strategy for how the Service intends to rationalize

[16]GAO, *U.S. Postal Service: Vulnerability to Fluctuating Fuel Prices Requires Improved Tracking and Monitoring of Consumption Information*, GAO-07-244 (Washington, D.C.: Feb. 16, 2007).

the postal facilities network and remove excess processing capacity and space from the network, as well as identifying the costs savings and other benefits associated with network rationalization alternatives discussed in the plan. This plan provides an opportunity to address some concerns we have raised in previous work, in which we stated that it was not clear how the Service intended to realign its processing and distribution network and workforce, and that its strategy lacked sufficient transparency and accountability, excluded stakeholder input, and lacked performance measures for results.[17] We are currently conducting ongoing work on the Service's progress in this area over the past 2 years and will be issuing a report this summer with updated findings.

Taking advantage of the opportunities available will have a direct impact on the Service's ability to operate under an inflationary-based rate cap, achieve positive results, and limit the growth in its debt. If the Service is unable to achieve significant cost savings, it may have to take other actions such as borrow an increasing amount each year to make year-end property and equipment purchases and fund its retiree health obligations. The following uncertainties may have a significant impact on the Service's ability to achieve real cost savings and productivity in the future:

- How will operating under a rate cap provide an incentive to control costs?
- How will the Service operate under a rate cap, if certain key costs continue to increase at levels above inflation (e.g., health benefit costs)?
- How will the new rate designs/structure lead to efficiency improvements throughout the mail stream?
- Will the Service's implementation of its network realignment result in greater cost savings and improved efficiency?
- Will the Service achieve its expected return on investment and operational performance when it deploys the next phase of automated flat sorting equipment?

[17]GAO, *U.S. Postal Service: The Service's Strategy for Realigning Its Mail Processing Infrastructure Lacks Clarity, Criteria, and Accountability*, GAO-05-261 (Washington, D.C.: Apr. 8, 2004).

- How will the Service's financial situation be impacted when the 10-year scheduled payments into the PSRHBF are completed?
- Will the balance of the PSRHBF—which is a function of the PSRHBF's investment returns and the growth in the Service's retiree health obligations—be sufficient to cover the Service's retiree health obligation by the end of fiscal year 2016?

## Maintaining, Measuring, and Reporting Service

The Service will be challenged to continue carrying out its mission of providing high-quality delivery and retail services to the American people. Maintaining these services while establishing reliable mechanisms for measuring and reporting performance will be critical to the Service's ability to effectively function in a competitive market and meet the needs of various postal stakeholders, including:

- The Service—so that it can effectively manage its nationwide service and respond to changes and/or problems in its network.
- The Service's customers (who may choose other alternatives to the mail)—so that they are aware of the Service's expected performance, can tailor their operations to those expectations, and understand the Service's actual performance against those targets.
- Oversight bodies—so that they are aware of the Service's ability to carry out its mission while effectively balancing costs, service needs, and the rate cap; can hold the Service accountable for its performance; and understand service performance (whether reported problems are widespread or service is getting better or worse).

The Service's delivery performance standards and results have been a long-standing concern for mailers and Congress.[18] We found inadequate information is collected and available to both the Service and others to understand and address delivery service issues. Specifically, the Service does not measure and report its delivery performance for most types of mail (representative measures of delivery performance cover less than one-fifth of mail volume and do not include key types of mail such as Standard Mail, bulk First-Class Mail, Periodicals, and most Package Services), certain performance standards are outdated; and that progress

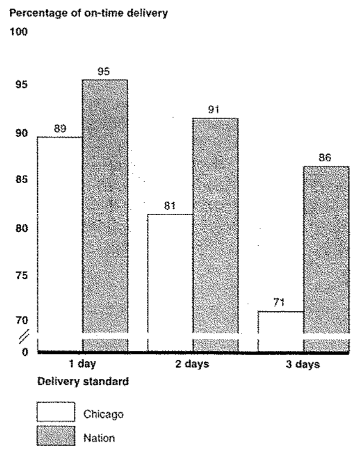
[18]GAO, *U.S. Postal Service: Delivery Performance Standards, Measurement, and Reporting Need Improvement*, GAO-06-733 (Washington, D.C.: July 27, 2006).

has been hindered by a lack of management commitment and collaboration by the Service and mailers. Based on these findings, we recommended the Service take actions to modernize its delivery service standards, develop a complete set of delivery service measures, more effectively collaborate with mailers, and improve transparency by publicly disclosing delivery performance information.

The Service has recently reported positive delivery results for the limited segment of mail for which the Service does track performance. It has reported on-time delivery performance improved in the first quarter of fiscal year 2007 for some single-piece First-Class Mail.[19] However, issues such as late deliveries have been reported in places such as Chicago, Los Angeles, and El Paso; and for different types of mail such as Standard Mail and Periodicals. Figure 6 shows that delivery performance in Chicago for this type of mail was worse than the national average at the end of the first quarter for this fiscal year.

[19]The External First-Class Measurement System (EXFC) measures delivery performance for single-piece First-Class Mail deposited in collection boxes in selected areas of the country. EXFC is not a systemwide measurement of all First-Class Mail performance.

**Figure 6: Delivery Performance in Chicago Was Below the National Average for Some Single-Piece First-Class Mail at the end of First Quarter, Fiscal Year 2007**




Source: GAO analysis of Postal Service delivery information.

The reform act provides an opportunity for the Service to address this challenge by establishing requirements for maintaining, measuring, and reporting on service performance. Specifically, the act identified four key objectives for modern service standards:

- enhance the value of postal services to both senders and recipients;
- preserve regular and effective access to postal services in all communities, including those in rural areas or where post offices are not self-sustaining;
- reasonably assure Postal Service customers delivery reliability, speed, and frequency consistent with reasonable rates and best business practices; and
- provide a system of objective external performance measurements for each market-dominant product as a basis for measurement of Postal Service performance.

The act also required the Service to implement modern delivery performance standards, set goals for meeting these standards, and annually report on its delivery speed and reliability for each market-dominant product. Key steps specified in the act include that within 12 months of enactment (by December 2007) the Service must issue modern service standards, and within 6 months of issuing service standards the Service must, in consultation with the PRC, develop and submit to Congress a plan for meeting those standards. Furthermore, within 90 days after the end of each fiscal year the Service must report to PRC on the quality of service for each market-dominant product in terms of speed of delivery and reliability, as well as the degree of customer satisfaction with the service provided.[20]

These requirements provide opportunities to resolve long-standing deficiencies in this area. As the Service transitions to the new law, the following uncertainties may impact its ability to address challenges in maintaining, measuring, and reporting service performance in the future:

- How will the Service implement representative measures of delivery speed and reliability within the timeframes of the reform act, while taking cost and technological limitations into account?
- How much transparency will be provided to the PRC, Congress, mailers, and the American people, including the frequency, detail, and methods of reporting?

## Financial Performance Reporting

Another challenge facing the Service is to provide reliable data to management, regulators, and oversight entities to assess financial performance. Accurate and timely data on Service costs, revenues, and mail volumes helps provide appropriate transparency and accountability for all postal stakeholders to have a comprehensive understanding of the Service's financial condition and outlook and how postal rates are aligned with costs. Earlier I discussed the past issues we have raised related to the Service's financial reporting and the improvements that the Service has

[20]The act further stipulates that the PRC must provide an opportunity for public comment on the report and must, within 90 days of receiving the annual service data from the Postal Service, make a written determination of compliance as to whether any service standards were not met. If PRC finds noncompliance, it is required to order the Service to take such action as PRC considers appropriate to achieve compliance. PRC also can fine the Service in cases of deliberate noncompliance.

recently made. We have also reported on the long-standing issues of ratemaking data quality that continue to persist.[21]

The act establishes new reporting and accounting requirements that should help to address this challenge. The major change is the establishment of, and authority provided, to the new PRC to help enhance the collection and reporting of information on postal rates and financial performance (see table 2).

**Table 2: Selected PRC Responsibilities for Financial Transparency, Oversight, and Accountability**

| Subject | PRC Responsibilities |
|---|---|
| Oversight of market-dominant products | • Prescribes by regulation the form and content of annual Service reports that analyze costs, revenues, and rates, using methods that PRC must prescribe, and in sufficient detail to demonstrate compliance with applicable requirements. Specify which reported information shall be made public. Initiate proceedings as necessary to improve the quality, completeness, or accuracy of this information.<br>• Annually determine whether rates are in compliance, after providing an opportunity for public comments on the Service's annual reports.<br>• If rates are not in compliance, order the Service to take appropriate action to come into compliance and remedy the effects of noncompliance, such as ordering rates to be adjusted to lawful levels.<br>• Consider any complaints that rates are not in compliance, which stakeholders may file at any time during the year. |
| Oversight of competitive products | • Establish regulations that ensure that each competitive product covers its attributable costs, prohibits the cross-subsidization of competitive products by market-dominant products, and ensures that competitive products collectively cover what PRC determines to be an appropriate share of the Service's institutional costs (overhead costs).<br>• Consider any complaints that stakeholders may file at any time during the year. If noncompliance is found, PRC must order the Service to take appropriate action to come into compliance and remedy the effects of any noncompliance, such as requiring the Service to make up for revenue shortfalls in competitive products. |

[21]GAO, *U.S. Postal Service: Improving Ratemaking Data Quality through Postal Service Actions and Postal Reform Legislation*, GAO-05-820 (Washington, D.C.: July 28, 2005).

| Subject | PRC Responsibilities |
|---|---|
| Financial reporting | • Receive annual, quarterly, and other periodic reports from the Service that contain information required by the Securities and Exchange Commission (SEC) for registrants[a] The annual report must also include information on the Service's pension and post-retirement health obligations. Receive reports on the Service's compliance with rules prescribed by the SEC for registrants in implementing section 404 of the Sarbanes-Oxley Act of 2002. Initiate proceedings as necessary to improve the quality, completeness, or accuracy of this information.<br>• Establish the accounting principles and practices that the Service must follow.<br>• In establishing the Service's accounting principles and practices, consider recommendations of the Department of the Treasury, including how to value assets and liabilities associated with providing competitive products, among other factors. |

Source: Pub.L. No. 109-435.

[a]The Postal Service is deemed the "registrant" by the reform act, however the Service is not a registrant for the purposes of submitting reports to the SEC.

Service officials have acknowledged the importance of financial reporting, but stated that there are cost implications associated with these improvements. The Service has recognized that it will incur costs in complying with the Securities and Exchange Commission's (SEC) internal control reporting rules and by changes needed to provide separate information for competitive and market-dominant products. We have reported that significant costs have been associated with complying with the SEC's implementing regulations for section 404 of the Sarbanes-Oxley Act, but have also reported that costs are expected to decline in subsequent years given the first-year investment in documenting internal controls.[22]

As the Service transitions to these new reporting and accounting requirements, its ability to address future challenges in this area will be impacted by uncertainties including:

- How will the PRC use its discretion to define and implement the new statutory structure?

- What criteria will PRC use for evaluating the quality, completeness, and accuracy of ratemaking data, including the underlying accounting data and

[22]GAO, *Internal Control: Analysis of Joint Study on Estimating the Costs and Benefits of Rendering Opinions on Internal Control over Financial Reporting in the Federal Environment*, GAO-06-255R (Washington, D.C.: Sept. 6, 2006); *Sarbanes-Oxley Act: Consideration of Key Principles Needed in Addressing Implementation for Smaller Public Companies*, GAO-06-361 (Washington, D.C.: Apr. 13, 2006).

additional data used to attribute costs and revenues to specific types of mail?

- How will PRC balance the need for high-quality ratemaking data with the time and expense involved in obtaining the data?
- How will PRC structure any proceedings to improve the quality of ratemaking data and enable the Service and others to participate in such proceedings? What proceedings might PRC initiate to address data quality deficiencies and issues that PRC has raised in its recent decision on the rate case?
- How will the Service be impacted by the costs associated with complying with the SEC rules for implementing section 404 of the Sarbanes-Oxley Act, as well as for the requirement of separate information for competitive and market-dominant products?

## Managing Its Workforce

The Service will be challenged to manage its workforce as it transitions to operating in a new postal environment. The Service is one of the nation's largest employers, with almost 800,000 full and part-time workers. Personnel-related costs, which include compensation and benefits, are the Service's major cost category and are expected to increase due to the reform legislation requirements to begin prefunding retirement health benefit costs. We have reported on the human capital challenges facing the Service, but have found the Service has made progress in addressing some of these challenges by managing retirements, downsizing, and expanding the use of automation.[23]

Provisions in the reform act related to workforce management can build on these successes. As part of the Postal Service Plan mandated by the act, the Service must describe its long-term vision for realigning its workforce and how it intends to implement that vision. This plan is to include a discussion of what impact any facility changes may have on the postal workforce and whether the Postal Service has sufficient flexibility to make needed workforce changes.

The Service, however, faces human capital challenges that will continue to impact its financial condition and outlook:

[23]GAO-04-108T and GAO-05-453T.

- *Outstanding labor agreements*: Labor agreements with the Service's four major unions expired late in calendar year 2006. In January 2007, the Service reached agreements with two of these unions, including semi-annual cost-of-living adjustments (COLA) and scheduled salary increases. Labor agreements, however, remain outstanding for the other two unions that cover over 42 percent of its career employees.

- *Workforce realignment*: As the Service continues to make significant changes to its operations (i.e., rationalize its facilities, increase automation, improve retail access, and streamline its transportation network), it will be challenged to realign its workforce based on these changes. This challenge may become more significant as mailers alter their behavior in response to the new rate structure. These actions will require a different mix in the number, skills, and deployment of its employees, and may involve repositioning, retraining, outsourcing, and/or reducing the workforce.

- *Retirements*: The Service expects a significant portion of its career workforce—over 113,000 employees—to retire within the next 5 years. In particular, it expects nearly half of its executives to retire during this time. The Service's decisions regarding these retirements (that is, whether or not to fill these positions, and if so, when, with whom, and where) may have significant financial and operational effects.

The following uncertainties will affect the Service's ability to address workforce-related challenges in the future:

- How will the Service be able to respond to operational changes? How will the Service balance the varying needs of diverse customers when realigning its delivery and processing networks?

- How will employees and employee organizations be affected and informed of network changes and how will the Service monitor the workplace environment?

- How will the resolutions to the outstanding labor agreements affect the Service's financial condition?

- How will the Service take advantage of flexibilities, including allowing more casual workers to deal with peak operating periods?

## Key Issues and Areas for Continued Oversight

The Postal Service, the PRC, and mailers face a challenging environment with significant changes to make in the coming months related to implementing the recent rate decision and the new postal reform law. We have identified several major issues considered significant by various postal stakeholders, as well as areas related to implementation of the law that will warrant continued oversight. Specifically, focusing attention on these issues during this important transition period will help to ensure that the new statutory and regulatory requirements are carried out according to the intent of the reform act and that the Service's future financial condition is sound. These key issues and areas for continued oversight include:

- the effect of the upcoming rate increases and statutory changes on the Postal Service's financial condition;
- the decision by the Service whether or not to submit a rate filing under the old rate structure;
- actions by the PRC to establish a new price-setting and regulatory framework;
- the Service's ability to operate under an inflationary price cap while some of its cost segments are increasing above the rate of inflation;
- actions by the Service, in consultation with the PRC, to establish modern service standards and performance measures, and the Postal Service's plan for meeting those standards;
- the Service's ability to maintain high-quality delivery service as it takes actions to reduce costs and realign its infrastructure and workforce; and
- the PRC's development of appropriate accounting and reporting requirements aimed at enhancing transparency and accountability of the Service's internal data and performance results.

One of the most important decisions for monitoring in the short term is whether or not the Service decides to file another rate increase before the new rate structure takes effect. The trade-offs involved in the Service's decision on whether to file under the new or old systems include weighing the respective costs, benefits, and possible unintended consequences of the Service's need for new rates along with the time and resources required by the Service, the PRC, and the mailing industry to proceed under either the new or old systems. For example, the Service may benefit from filing under the old system because it would allow the Service to further align costs with prices prior to moving into price-cap restrictions. Under the old rules, the Service would have to satisfy the "break-even" requirements that postal revenues will equal as nearly as practicable its total estimated costs. Under the new rules, the Service would have to ensure that rate increases for its market-dominant products do not exceed a cap based on the growth in the Consumer Price Index. Filing under the old system, however, could put additional strain on mailers and the PRC. In particular, the PRC would be reviewing the Service's rate submission while transitioning to its new roles and responsibilities under the legislation—establishing a new organization structure, a new regulatory framework with new rules and reporting requirements, which must include time for public input, and a multitude of additional requirements.

Recognizing these challenges, the Chairman of the PRC has suggested (and asked for public comments on) that rather than expending resources on extending the application of the old system, the PRC would work with the Service and mailers to implement the new regulatory systems even sooner than the 18 months allotted by the new law. This action could allow the Service to implement new rates sooner under the new regulatory system depending upon when the PRC completes its work and the Service chooses to file new rates. The Service's decision will not only impact its financial performance and condition, but also the mailing industry and the focus of the PRC.

Another key provision of the law that warrants close oversight is the requirement for the Service to develop modern service standards. We are encouraged by the Service's actions to date to establish a workgroup that includes participants from the mailing industry to review and provide recommendations on service standards and measures. This workgroup is expected to complete their work in September of this year, and the Service is to make its decisions on the new service standards by December 20, 2007. The Service then has 6 months to provide Congress with a plan on how it intends to meet these standards, as well as its strategy for realigning and removing excess capacity from the postal network. We believe this plan is a particularly important opportunity to increase transparency in these areas, particularly given the changes to the Service's plans for network realignment and the limited information available to the public. We will be reporting this summer on the status and results of the Service's efforts to realign its mail processing network.

Finally, the PRC's role in developing reporting requirements is critical to enhancing the Service's transparency regarding its performance results. Congress was particularly mindful in crafting the reform act to ensure that the provisions for additional pricing flexibility were balanced with increased transparency, oversight, and accountability. The new law provides the regulator with increased authority to establish reporting rules and monitor the Service's compliance with service standards on an annual basis.

The successful transformation of the Postal Service will depend heavily upon innovative leadership by the Postmaster General and the Chairman of the PRC, and their ability to work effectively with their employees, employee organizations, the mailing industry, Congress, and the general public. It will be important for all postal stakeholders to take full advantage of the unique opportunities that are currently available by providing input and working together, particularly as challenges and uncertainties will continue to threaten the Service's financial condition and outlook.

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

## Contact and Acknowledgments

For further information regarding this statement, please contact Katherine Siggerud, Director, Physical Infrastructure Issues, at (202) 512-2834 or at siggerudk@gao.gov. Individuals making key contributions to this statement included Teresa Anderson, Joshua Bartzen, Kenneth John, John Stradling, Jeanette Franzel, Shirley Abel, Scott McNulty, and Kathy Gilhooly.

# Appendix I: Summary of Recent Rate Developments

| Date | Description | Rate increase, on-average | First-Class stamp rate[a] |
|---|---|---|---|
| 5/3/06 | **Postal Service submits proposal to Postal Rate Commission (PRC)[b]**<br>• Requests rate increases effective May 2007.<br>• Proposes Forever Stamp[c]<br>• Establishes pricing structure based on mail weights and shapes:<br>  • Revises old structure which was primarily weight-based.<br>  • Recognizes that different mail shapes have different processing costs.<br>  • Gives mailers an opportunity to minimize their rates by altering shape of mail. | 8.1 percent | 42 cents |
| 2/26/07 | **PRC issues recommended decision on Service's proposal**<br>• Issued after detailed administrative proceeding involving mailers, employee organizations, consumer representatives and competitors.<br>• Recommends revisions to many of the rates and rate designs submitted by the Service:<br>  • Increases rates substantially for some types of mail.<br>  • Revised rates are intended to more accurately reflect costs and send proper pricing signals.<br>• Approves Forever Stamp.<br>• Concurs with shape-based pricing structure and, according to the PRC, the change in rates will still meet the Service's revenue needs.<br>• Anticipated that this would have been the last rate case initiated prior to implementation of the new rate structure established under the reform legislation and explained that its recommended rates are intended to provide a sound foundation for the future. | 7.6 percent | 41 cents |
| 3/19/07 | **Postal Service's Board of Governors issues decision to implement PRC-recommended rates**<br>• Implements most rates effective May 14, 2007.<br>• Asks PRC to reconsider some rates, most notably those for flat-sized Standard Mail, which is generally advertising and direct mail solicitations (this could lead to further changes in these rates).<br>• Delays rate implementation for Periodicals for over 2 months, citing reactions of magazine mailers and the publishing industry's need to update software.<br>• Begins sale of Forever Stamp starting April 12; stamp will be valid for postage starting May 14. | 7.6 percent | 41 cents |

Source: U.S. Postal Service and Postal Regulatory Commission documents.

[a]First-Class stamp prices cover letters weighing up to 1 ounce that are sent via First-Class Mail.

[b]The name of the Postal Rate Commission was changed to the Postal Regulatory Commission due to provisions of the Postal Reform and Enhancement Act.

[c]The Forever Stamp will sell at the First-Class one-ounce letter rate, and will continue to be worth the price of a First-Class one-ounce letter even if that price changes.

**Additional Questions for the Record**
**For Postmaster John Potter**
**United States Postal Service**
**Submitted by Senator Daniel K. Akaka**
**Committee on Homeland Security and Governmental Affairs**
**Subcommittee on Federal Financial Management, Government Information,**
**Federal Services, and International Security**
**"The Road Ahead: Implementing Postal Reform"**
**April 20, 2007**

Establishing Service Standards

1. During the hearing, I asked you about the Postal Service's views on consultation between itself and the Postal Regulatory Commission in establishing service standards. Section 3961(a) of the Postal Accountability and Enhancement Act (PAEA) states:

   *(a) Authority Generally.--Not later than 12 months after the date of enactment of this section, the Postal Service shall, in consultation with the Postal Regulatory Commission, by regulation establish (and may from time to time thereafter by regulation revise) a set of service standards for market-dominant products.*

   In the Government Accountability Office's testimony before the subcommittee, they stated that maintaining services "while establishing reliable mechanisms for measuring and reporting performance will be critical to the Service's ability to effectively function in a competitive market and meet the needs of various postal stakeholders..." I believe it makes clear that the development of these service standards must be as thoughtful and thorough as possible.

   In your testimony, you stated that the Postal Service had invited the PRC to sit in on and participate in meetings of the Mailers Technical Advisory Committee (MTAC). You also stated that after the conclusion of these meetings, you looked forward to discussing service standards with the PRC.

   A. Does the US Postal Service believe that the current participation of the PRC in these MTAC meetings satisfies the statutory requirement for consultation as laid out in Section 3961 of the PAEA?

   **No. The Postal Service intends to establish a separate, more formal consultation process with the PRC. The first meeting with the PRC as part of the consultation process occurred on May 25, 2007. We developed a plan for future consultations at that meeting.**
   **The Postal Service invited the PRC to participate on the MTAC workgroup to allow the PRC to discuss service standards and performance measurement from the customers' viewpoint. This process introduced the PRC to the ongoing industry-USPS**

**engagement process that we have used to address issues with significant internal and external impacts for over 40 years.**

B. If you believe this does satisfy the statutory requirement, are you planning additional consultation with the PRC after the MTAC meetings have finished, in developing these service standards?

**See A.**

C. Did the Postal Service in any way convey their view of PRC's role in these meetings as it applied the consultation requirement?

**No. The Postal Service invited the PRC to take part in the workgroup as a full participant in the MTAC effort. The Postal Service did not represent the PRC in any way.**

D. What is the timeline for issuing these new service standards?

**The Postal Service will meet the requirements of the new law to establish service standards for all market-dominant products by December 20, 2007.**

Contracting Postal Routes

2. During the hearing, I asked you about the contracting out of mail routes by the US Postal Service. You stated that if a current route was filled by a letter carrier, it would be filled by a letter carrier, and that the focus of contracting was only on new routes.

   I have been told by constituents in Hawaii that Postal Service managers are receiving orders that all new routes should be contracted rather than filled by a postal employee.

   A. Has the Postal Service, at any level, given explicit or implicit orders to local and regional managers to fill all new routes with a contractor rather than a postal employee?

**The Postal Service has not issued any instructions, at any level, that all new routes must be serviced by contract delivery service. The Postal Service has reminded its field managers to review new deliveries for their potential to provide service through contract delivery service. In 1996, 1997, 1999, 2001 and 2002, the Delivery Office at Postal Headquarters sent instructions to Postal Areas and Districts to remind them of their options when assigning new routes and deliveries. These instructions also included reminders about the Postal Service's requirements under the provisions of the applicable collective bargaining agreements.**

**The Postal Service must consider several factors pursuant to the negotiated collective bargaining agreements when considering whether to assign new deliveries to contract delivery. These factors include consideration of public interest, cost, efficiency, availability of equipment, and qualification of employees.**

**You may be assured that the Pacific Area and the Honolulu District offices have not issued any orders to field managers requiring them to fill all new routes with contract delivery service. The Honolulu District office has sent messages to their field managers that contract delivery service should be considered when evaluating delivery options for new developments. The Honolulu District evaluates each new development on a case-by-case basis, in accordance with the factors cited in the negotiated collective bargaining agreements.**

B. Can you provide data as to which new routes last year were given to contractors versus a new employee, and how many of these routes were rural versus urban? Please provide this information both for Hawaii specifically, as well as nationwide.

**In fiscal year 2006, the Postal Service created 73 new city delivery routes, 2,279 new rural delivery routes, and 219 new contract delivery routes.**

**In Hawaii, for fiscal year 2006, the Postal Service added 2 additional city delivery routes, 11 rural routes, and 1 contract delivery route. Year-to-date fiscal year 2007 statistics show that the Postal Service has added 4 city routes, 4 rural routes and no contract delivery routes in Hawaii.**

<u>Veterans Preference</u>

3. Your answer to my hearing question concerning the conformance of USPS repositioning rules with reduction in force (RIF) and veterans preference requirements appeared only to address the voluntary phase of USPS's repositioning efforts, in which a non-bargaining employee is reassigned to a position of their choice in the event of an organization or staffing change.

   As your May 31, 2005, letter to me acknowledged, involuntary repositioning procedures may additionally become necessary, in which a non-bargaining employee may be involuntarily reassigned outside the geographic area, without resort to RIF or preference-eligible protections.

   A. Your May 31, 2005, letter to me provided FY 2003 and FY 2004 statistics concerning the number of restructurings and non-bargaining employees impacted, including preference-eligible employees. Please provide comparable data for FY 2005 and FY 2006.

**Data concerning the number of restructurings and non-bargaining employees impacted, including preference-eligible employees for FY 2005 and FY 2006 is as follows:**

| | Impacted PCES EAS | Preference Eligible | Involuntarily reassigned to equal level jobs within commute | Preference - Eligible RIF Separation |
|---|---|---|---|---|
| FY 2005 | 372 | 71 | 0 | 0 |
| FY 2006 | 382 | 55 | 4 | 0 |

**No bargaining unit employees have been subject to a reduction in force or laid-off under the repositioning regulations. Any reduction or reassignment of bargaining unit employees has occurred by following the requirements of Article 12 of the collective bargaining agreements. Under the terms of the collective bargaining agreements, veteran's preference is observed if the placement is to a lower pay level. If placement is to the same or higher pay level, the impacted employee's seniority is observed.**

B. In addition, please describe the rights and protections available to veterans at USPS who are subject to involuntary repositioning rules.

**If the employees believe that the reassignment violated their veteran preference status, they may appeal to the U.S. Merit Systems Protection Board. If they believe that the reassignment violated the anti-discrimination statutes, they may file an EEO complaint.**

Can you also provide me with the following data:

1. Total number of preference-eligible employees at USPS:

**There are a total of 179,509 preference-eligible employees in the Postal Service.**

2. Number of non-preference-eligible employees (EAS and PCES) who were separated due to a RIF related to the repositioning (2003 to present):

**Since 2003, 46 non-bargaining (management) employees have been separated because of a RIF related to repositioning.**

3. Number of non-preference-eligible employees (EAS and PCES) who took early retirement due to the repositioning (2003 to present):

**Since 2003, 1,394 non-bargaining (management) employees have taken early retirement as a result of repositioning. No bargaining unit employees have been subject to a reduction in force.**

4. Number of non-preference-eligible employees who were involuntarily reassigned outside their commuting area:

**We do not track the reassignments of non-preference eligible employees outside of their commuting area or within their commuting area.**

5. Number of preference-eligible employees (EAS and PCES) who were involuntarily reassigned outside their commuting area:

**Since 2003, no preference eligible employees have been involuntarily reassigned outside their commuting area.**

6. Number of non-preference-eligible employees who were involuntarily reassigned inside their commuting area:

**Reassignments within the commuting area are a discretionary complement- management tool. We do not track reassignments of non-preference-eligible employees**

7. What happened to all of the 714 preference-eligible employees (e.g., early retirement, forced to move outside the commuting area, take lower paying jobs in the area, etc.) who were impacted by the repositioning.

**The 714 preference-eligible employees experienced one of the following outcomes:**

- **Promoted through limited competition**
- **Reassigned to the same level – voluntary request or limited competition**
- **Reassigned to a lower level – voluntary request (salary protected)**
- **Voluntarily retired (either voluntary early retirement or optional retirement)**

8. Also, how many more employees do you expect to be impacted by the repositioning rules over the next 5 years in addition to the number of preference-eligible employees in that number?

**We cannot provide an answer at this time. Reductions in Force are limited to competitive areas where the organization/staffing changes meet the criteria for invoking RIF procedures.**

9. As for the next five years, I'm interested in your plans for future repositioning. If the need for the repositioning is closing/consolidating/reorganizing USPS facilities, I would assume that the USPS has a plan for moving forward and would have an idea of the number of employees at each of those facilities that would be impacted. Or does the USPS not foresee the need to reposition in the near future?

**As we are still reviewing our facility needs, we could not speculate on which facilities or how many employees would be affected by future network changes.**

Questions of Senator Pete V. Domenici for a Hearing before the Senate Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security Committee on Homeland Security and Governmental Affairs
April 19, 2007

**For**: Postmaster General/CEO John E. Potter
United States Postal Service

**Subject**: New Mexico Postal Issues

**Background:** I appreciate your continued efforts to improve the Postal Service in New Mexico. I believe that progress has been made since you and I last met. I am grateful for the genuine interest you have shown regarding the postal needs in my home state and I would also like to thank you for meeting with me on prior occasions to discuss these issues.

Yesterday, the Postal Service issued a press release stating their plans to call for postal officials in Albuquerque to add 75 new employees. It is my understanding that the Rio Rancho area has seen improvement in recent months. The Postal Service has recently stated that it will concentrate on bringing Albuquerque proper, especially the far north east heights up to speed. I believe that these improvements are significant; however, there is more work that must be done.

I continue to receive complaints and consistently read stories in the papers related to the Postal Service in New Mexico. In Las Cruces, Albuquerque, Roswell, and Santa Fe, the mail is consistently late, undelivered, and in some areas vandalized. Postal service remains at a substandard level and New Mexicans continue to complain about the need for better postal service.

Local mail carriers have complained of mail being improperly sorted or not sorted at all which may mean that the plant in Albuquerque is not processing mail correctly. I have also been informed that the Postal Service in New Mexico continues to recruit substandard employees.

A separate issue that has been brought to my attention is that the Postal Service has instituted a nationwide change in postal processing by utilizing Area Distribution Centers. Recent problems with the delivery of mail have been attributed to mechanical failures with two processing machines at these area distribution centers.

**Questions:** I am pleased with the Postal Service's recent announcement pertaining to the addition of seventy-five new employees in Albuquerque. I believe that this is a step in the right direction and I hope that the Postal Service will continue to employ innovative and flexible strategies as it continues to evolve. However, there is still room for improvement especially in my home state of New Mexico.

1. I have heard reports that mail currently at the El Paso facility is not being processed for delivery in Las Cruces and has remained in a stagnant state for four or more days. Moreover, I am told that this problem has been caused by a lack of personnel at the El Paso Facility. I would like your assurance that you will look into this matter further and let me know your findings, especially what you learn about the personnel situation in El Paso.

   **On-site visits to the El Paso Processing and Distribution Center (P&DC) by USPS Southwest Area staff ensure that processing operations are current for all mail classes and destinations. The recent monthly reviews found that operations, including those serving Las Cruces, were in good standing and current.**

   **The Senior Plant Manager for the Rio Grande District, which includes El Paso, also makes regular visits and reviews operations in El Paso to ensure that his expectations are met.**

   **Daily condition reporting shows El Paso to be current; District and Area on-site reviews validate the reporting.**

   **The El Paso P&DC currently has 286 employees, 12 more employees as compared to the first of the calendar year. By June, we will have added 15 more employees.**

   **The Postal Service continually evaluates complement levels to provide good service to our customers at reasonable costs.**

2. It is unclear what benefits are provided by the area distribution centers, which are located in Texas and process the New Mexico mail. My office was recently informed that slow deliveries were the result of mechanical problems at the area distribution centers. Are the distribution centers adequately staffed and maintained?

   **Area Distribution Centers (ADC) group mail by origin plants across the country, to dispatch to the destination sorting sites. The ADC concept is not new. This mail processing method has been used for many years to provide fast and efficient service for mail that is transported across the nation.**

   **Mail for Las Cruces, New Mexico, is processed at the El Paso P&DC for a number of reasons. The proximity of Las Cruces to El Paso is the primary reason we use the El Paso P&DC. The distance between Las Cruces and El Paso is 47 miles, versus 223 miles between Las Cruces and Albuquerque. The El Paso plant also has the automation capacity, which enables it to add new delivery zones and maintain quality service for postal customers in El Paso and Las Cruces.**

**The El Paso P&DC has not experienced any significant mechanical breakdowns that have affected mail service.**

**This facility has 286 employees, 12 more employees as compared to the first of the calendar year. By June 1, we will have added 15 additional employees.**

**Concerning maintenance of our sorting equipment, the 68 maintenance employees in the El Paso P&DC are some of the best in the nation. Over the last year, the El Paso Maintenance Manager and his staff received recognition for demonstrating the best performance in the Southwest Area.**

3. What is the efficiency record of the area distribution centers that serve New Mexico?

   **The USPS Southwest Area operates 23 plants that serve as distribution centers. The El Paso P&DC continues to lead the Southwest Area in productivity and efficiency. The U. S. Postal Service determines efficiency by comparing productivity against mail volume. During the current Postal Quarter, the El Paso P&DC is the highest ranked plant in the Southwest Area. This plant processed more mail in FY 2006 than the previous year, using fewer work hours.**

4. What are you doing to recruit and retain quality employees in New Mexico?

   **The USPS hiring policy requires that we select applicants through our exam/testing process, with selection based on scored rankings. Additionally, new hires must successfully pass driving exams and drug testing, as well as criminal background checks.**

   **The Albuquerque District widely advertises testing opportunities to ensure a large pool of tested recruits. Once new employees are hired, it becomes a matter of leadership and development. The Albuquerque District trains new employees during the probationary period, and beyond, to develop and retain successful employees.**

5. My office continues to hear complaints about late, undelivered, and in some areas vandalized mail. New Mexicans rely on the Postal Service to deliver time sensitive priority items like medication, bills, and social security checks. What is the Postal Service doing in New Mexico to address these serious concerns?

   **From April 19 through September 30 of this year, we will have added 80 additional employees to fill identified Albuquerque District personnel vacancies to resolve late and non-delivery complaints.**

**We are also adding new automation and mail processing equipment to advance mail from processing plants to delivery units, which allows carriers to leave their respective offices earlier in the day and provide timely delivery to our customers.**

**Vandalism is a serious problem in New Mexico and our Inspection Service is working closely with New Mexico's local and state law enforcement officials to apprehend and prosecute vandals. Attacks on our Neighborhood Delivery Collection Box Units (NDCBU) in high-crime rate areas resulted in an initiative to replace over 2,497 NDCBUs with security hardened Cluster Box Units (CBU). As a result of this initiative, the state of New Mexico realized a 75 % reduction in the mail theft from collection boxes.**

**Density tests were also conducted to evaluate the placement and/or removal of NDCBUs/CBUs. Anti-fishing devices were used to prevent the theft of mail out of the blue Collection Boxes, and locking mechanisms for blue "monster boxes" which prevent external locks from being cut off, also aid in curbing mail theft.**

**Through collaborative efforts with the law enforcement community and the Albuquerque Postal District, the State of New Mexico experienced a significant reduction of mail theft-related incidents for Fiscal Year 2006 and Year-To-Date 2007.**

6. The post office in Santa Fe handles passport applications and has seen a dramatic rise in applicants since a passport is now required for travel to Mexico and Canada. The postal facility there is currently averaging 30-50 applications a day. At this same time last year the application rate was about 15-25 a day. Currently, there are two clerks who handle passport applications in this office. These two clerks were notified the first of April that their jobs are being terminated the end of April and they are "encouraged" to re-bid for the new positions. What is the justification of this change and who will process passport applications in Santa Fe during this transition period?

**The demand for passports has grown significantly in New Mexico, as well as the entire nation, due to changes in passport and travel laws. The Santa Fe Post Office has no intention of reducing hours or eliminating passport acceptance jobs.**

**The duties of the two passport clerks were expanded, allowing them to serve customers who desire other retail services when there is no demand for passport processing. The primary duty of these two employees is to provide passport acceptance service. We would also like to add that a third employee is now qualified to process passports during peak demand periods or as backup for the two regular passport clerks.**

**The Santa Fe Post Office also holds Passport Fairs on weekends, in high-passport demand locations, as an added benefit for our customers.**

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

**"The Road Ahead: Implementing Postal Reform"**

**April 19, 2007**

1. I understand that the enactment of the postal reform bill will force the Postal Service to pay out $600 million more in cash that you were originally planning. I assume this money will be going towards the pre-funding of retiree health care and will come out of the sort of "rainy day fund" that you build into each of your rate filings. What impact will this $600 million have on your operations this fiscal year? Will it leave you enough to deal with contingencies; such a fuel price increases, for example, without resorting to excessive borrowing?

   **The $600 million of additional expense results from the difference between the retiree health benefits funding payment of $5.4 billion in FY2007 and the offsetting reductions in the escrow ($3.3 billion) and Civil Service Retirement System (CSRS) employer contributions ($1.5 billion).**

   **The Postal Service generally incorporates a contingency provision in rate filings, which is intended to provide a cushion to the financial estimates to compensate for unforeseen events and possibly inaccurate forecasts. The R2006-1 rate filing requested a contingency of one percent of estimated expense, or $784 million in the FY 2008 Test Year. Since filing this case in May 2006, the price of fuel, transportation costs, workers' compensation costs, and the September 2006 COLA adjustments to wages have increased well beyond the costs we estimated in the filing. Currently, these costs are expected to fully exhaust the contingency provision included in the R2006-1 rate filing.**

   **The additional $600 million of retiree health benefits expense is expected to result in an FY2007 loss. This loss, while not directly impacting operations, will require the Postal Service to borrow an additional $600 million at the end of FY2007.**

2. It's clear from the testimony we have before us today and from the financial data the Postal Service has released that you're going to need to borrow more this fiscal year than you have in the past. I'm used to seeing the Postal Service carrying little to no debt at all in recent years. Will this change? Can we expect that the Postal Service will be carrying more debt from year to year?

**The Postal Service ended last year with $2.1 billion of debt. We expect debt to total $3.9 billion at the end of Fiscal Year 2007. Each year, our borrowing requirements are largely determined by the difference between cash flow from operating activities and our cash outlays for capital investments. Last year's cash flow was influenced by the need to place $3 billion into escrow. This year's cash flow is influenced by the requirement to pay the $3 billion escrow amount and an additional $5.4 billion into the new Postal Service Retiree Health Benefit Fund. The Postal Service is required to continue pre-funding the retiree health benefits through 2016.**

**Looking forward to Fiscal Year 2008, we expect that any increase in debt will be smaller than this year's planned increase.**

3. At least some of what we've heard from the Postal Service since the enactment of postal reform has made it sound like the pre-funding of retiree health care will be a major burden on the Postal Service. My understanding, however, is that pre-finding will significantly reduce the Postal Service's health care obligations and put you in much better shape ten years down the road to handle any erosions in mail volume or other challenges. What are your thoughts on this?

   **P.L. 109-439 requires the Postal Service to pay more than would have been required under P.L. 108-18 in 2007-2010. In 2011-2016, the Postal Service will pay slightly less than would have been required by P.L. 108-18. We expect that, by the end of 2016, most of the Postal Service's obligation for previously earned retiree health benefits will be funded by the Postal Service Retiree Health Benefits Fund. Beginning in FY 2017, with the elimination of the requirement to pay both the retiree health benefits premiums as well as the scheduled pre-funding amounts, the Postal Service expects that the annual retiree health benefits costs will be reduced substantially.**

   **The key, though, to handling the financial impact of the erosion of mail volume, particularly the erosion of important First-Class Mail, will be achieving a balance between the cost of our services and the revenue that we can generate. The reduction in the retiree health benefits costs in 2017 certainly will be helpful in this balancing effort. But more important, effective control of labor and transportation costs through proper management and sizing of our network, the generation of new revenues, and a strong economy will have relatively larger impacts on our financial health.**

4. That same February press release I referred to earlier announced a 6.4 percent increase in volume for Standard Mail over the first quarter of Fiscal Year 2006. First Class Mail volumes were flat. Do you envision these trends continuing throughout the year and in coming years? What impact do you envision the rate case set to go into effect in May having on volume in these and other classes of mail?

**I believe that the figure you cite for Quarter 1 Standard Mail volume growth is actually the figure we reported for Quarter 1 Revenue growth. The Postal Service did issue a press release on February 9, 2007, providing highlights of our First Quarter results posted in our QI 2007 Report, also filed and publicly released on February 9. That release cites a 6.4 percent increase in first quarter revenue over Quarter 1, 2006, and also reports Standard Mail volume growth of 4.9 percent in Quarter 1, 2007, as compared to Quarter I, 2006.**

**The 4.9 percent Quarter 1 increase in Standard Mail was positively affected by election-related mail volume and negatively affected by the January 2006 rate increase. First-Class volumes were indeed flat, mostly because single-piece letters declined 1.7 percent. This decline was offset primarily by a 0.9 percent increase in workshared letters. This general trend of flat-to-negative First-Class Mail volume growth is expected to continue. We expect that Standard Mail volume will continue to increase at modest (low single-digit) rates.**

**The rate increase will depress mail volumes while raising revenues. Because of their high sensitivity to price changes, Priority Mail, Express Mail, Parcel Select and Enhanced Carrier Route Standard Mail volumes will all decline more than other subclasses of mail. As the Governors have stated, we have concerns about the impact of the rate increase on flat-shaped Standard Mail, such as catalogues.**

5. Senator Collins and I recently sent a letter to the Chairman Blair and the Postal Regulatory Commission, which I'll submit for the record, making it clear that our major goal in drafting and negotiating the final version of our postal reform bill was to provide mailers with predictability and stability in rates. We had heard from mailers in testimony and countless conversations that predictability and stability would allow them to better plan their mailings and could allow them to even increase the amount of business they do with the Postal Service. How does the Postal Service plan to work with the Postal Regulatory Commission now and under the new rate system to provide mailers with a greater level of predictability and stability?

**We certainly appreciate how important it is for the new pricing regime to give customers more stability and predictability. The regulatory framework set forth in the law makes market-dominant product prices more stable and predictable by allowing for changes at regular intervals and by tying price increases to CPI by class. This will allow for a more market-friendly pricing strategy, characterized by gradual, incremental price changes rather than large increases once every three or so years, which characterized the old pricing system.**

**We are working with the Commission to ensure that customers get the full benefit of the provisions for price moderation and predictability that the new law contains. We have conducted informal meetings with the Commission and are participating fully in the current PRC rulemaking concerning the establishment of rules and procedures for the new pricing system. At the same time, we have committed to a system of advance notification for future rate changes, pledging to notify customers at least three months prior to the annual, general price change.**

**We are preparing a more formal commentary on the structure of rates themselves and the timing of rate increases and how we believe those should be accomplished While it is clearly understood that our customers must have predictability, the Postal Service will also need the flexibility to adapt to changing conditions and needs of our operating and market environments. We have been sharing views with both customers and the Commission and have offered specific proposals as to what the rate-setting process should be.**

6.You stated in response to a question from Senator Akaka that the vast majority of existing routes and of new routes added in 2006 are worked by postal employees. If this is the case and there is not a an effort underway to contract out all or even most mail delivery, what criteria does the Postal Service use in determining whether a route should go to a postal employee or to a contractor?

**The Postal Service considers a number of factors when determining whether to assign new deliveries to a contractor. For example, factors considered pursuant to negotiated collective bargaining agreements include consideration to public interest, cost, and efficiency, availability of equipment and qualification of employees.**

**Additionally, when assigning new deliveries to routes, the Postal Service looks at the type of growth being developed. There are two basic categories of new deliveries, fill-in growth and new growth.**

**Fill-in growth is growth that occurs between existing delivery points or comprises a small pocket of deliveries on the same block face. This type of delivery is usually, but not always, assigned to the carrier (City, Rural or CDS) who has the route that is encompassing the existing delivery area.**

**New growth areas are new deliveries that are in new developments, such as a small subdivision or a new high rise. These deliveries are evaluated and may be assigned to contract delivery in compliance with the applicable collective bargaining agreements.**

7. My staff recently obtained a news article from Beaverton, OR in which it was reported that managers at the Beaverton post office had solicited bids for a contract delivery route through the web site Craigslist. It was also reported that the route was ultimately awarded to the son of a manager at the post office. This is hardly the kind of professional, transparent, and fair contracting process I expect from the Postal Service. Please explain for the record the process you use to solicit bids for mail delivery routes you are considering outsourcing.

**U.S. Postal Service transportation requirements are solicited and awarded by professional transportation contracting officers and their staffs.**

**While the Postal Service previously advertised solicitation opportunities on CraigsList, we are currently not using that Website to advertise contracting opportunities. The Postal Service has advertised and continues to advertise in libraries, local newspapers, local community centers, and stores. Additionally, when the Postal Service prepares a regular solicitation, a solicitation notice is also sent to potential suppliers who have indicated an interest in providing service in the specific area (through our National Offerors List), and notices for posting are sent to postmasters in offices to be serviced by the route. The Postal Service tries to ensure that its solicitations are widely distributed to ensure maximum competition.**

**The solicitation notification includes the following information: The solicitation number, contract number, total miles, total hours, historical cost, post office where the service is needed, and contact information to obtain a complete solicitation package.**

**Persons interested in competing for the contract must request a copy of the solicitation from the contracting office in the area. Potential suppliers are requested to submit documentation to support their financial capability, supplier eligibility, supplier capability, and past performance for evaluation. The contract is awarded based on specific evaluation criteria.**

**Our policy states that employees of the U.S. Postal Service or members of their immediate families are not eligible to hold an HCR contract.**

**"Immediate family" means spouse, minor child or children, and other individuals related to the employee by blood who are residents of the employee's household (Section 3.1 of the Contract Terms and Conditions).**

**When there are questions about eligibility, the contracting officer is required to obtain a ruling from a Postal Service ethical conduct officer.**

**The specific solicitation referenced in the question was an emergency contract award; the appropriate review was performed and approval was granted since the son of the Postal supervisor did not reside in the supervisor's household.**

**In this case, the son was awarded the contract by a Contract Transportation Specialist, not the supervisor at the Beaverton Post Office. The supervisor who was related to the supplier did not provide his son's name to the contracting officer. For contract delivery services, the postmaster manages the day-to-day operation of the service. In this specific case, the postmaster was advised that the supervisor *could not* manage his son's contract. This contract has since been solicited for regular service with a closing date of June 5, 2007, and effective date of August 1, 2007. Four bids had been received on this contract.**

8. I know that the Postal Service is in the process of realigning its mail processing network. What progress has been made since you first gave notice of this process to the then-Postal Rate Commission? Also, how are postal air mail center affected by the process? Can you tell the subcommittee which air mail centers across the country will be closed, which will be contracted out, and when these changes will occur? Specifically, are there any plans in place to close or contract out the Postal Service's air mail facility in Newark, NJ?

**We continue to make progress in achieving the goals of Postal network realignment: to develop mail processing and transportation networks suited to current and future operational needs; reduce inefficiency and redundancy; make operations flexible; and reduce costs.**

**Area Mail Processing (AMP) reduces costs and inefficiencies by consolidating all outgoing and/or incoming distribution operations from one or more post offices/facilities into one or more automated processing facilities for the purpose of improving operational efficiency and/or service.**

**Proposed savings are validated through two post-implementation reviews (PIR) conducted after implementation of approved AMPs. PIRs also assess service performance after consolidation of mail processing operations.**

AMP Status Report

- Two consolidations have been approved since filing the PRC Docket No. N2006-1 on February 14, 2006. Total annual savings for both is expected to be $8,639,463.

- The business case for two proposed consolidations will be presented later this year at public meetings in Kansas City KS and Bronx NY. Input from meeting attendees and written comments from stakeholders will be consolidated and provided to the Postal Service's senior vice president Operations to consider during his decision to approve or disapprove those specific AMP proposals.

- Nine AMPs were implemented in 2005. Based on post implementation reviews conducted since 2006, total annualized savings indicate the Postal Service saved $28,726,380 by consolidating mail processing operations.

Consolidation of AMC operations was not a part of the Evolutionary Network Development realignment plan submitted to the Commission for review in February 2006. Improvement of AMC operations is a separate initiative that is not expected to have any impact on service.

The Postal Service has considered two options intended to further improve efficiencies at these AMC locations after non-core AMC functions are shifted to other appropriate postal facilities.

1. In-House Option: The option through which AMC locations would be converted to Airport Transfer Centers (ATC), in new, properly-sized locations and staffed with postal personnel.

2. Contractor Option: The option through which a terminal- handling supplier would perform receipt (delivery from air transportation supplier) functions. Existing terminal operations would be co-located with commercial air carriers tender and receipt functions.

Our analysis leads us to conclude that the Contractor Option (# 2) is more efficient and cost-effective.

As a result, in September 2006, the Postal Service decided to outsource and award the contract(s) for terminal handing services at the St. Louis and Miami AMCs. On May 1, 2007, approval was given to outsource and award the contract(s) for terminal handing services at the following AMCs:

Baltimore, MD (BWI), Charlotte, NC (CLT), City of Industry (ONT), Denver, CO (DEN), Detroit, MI (DTW), Hartford, CT (BDL), Humble/Houston, TX (IAH), Indianapolis, IN (IND), Las Vegas, NV (LAS), Los Angeles, CA (LAX), Milwaukee, WI (MKE), San Antonio, TX (SAT), Seattle, WA (SEA) and St. Paul, MN (MSP).

We have followed the negotiated collective bargaining agreement provisions in making these determinations. While the language in each of the agreements is not identical in all respects, they contain provisions to which the parties have agreed regarding the reassignment of employees and the utilization of subcontracting.

For example, contracts contain an article or articles (usually Article 12) which deals with principles of seniority, posting and reassignment. With regard to reassignment, there are often detailed and extensive provisions covering such matters as notice and information to the union; the process for and rights of employees reassigned; and what happens when there are installations or routes discontinued or consolidated.

Contracts also contain a subcontracting article (usually Article 32). Within that article, there are agreements between the parties concerning provisions such as notification to the union and generally the considerations the Postal Service must take into account when evaluating the need to subcontract. There also may be Memorandums of Understanding or other agreements negotiated with the unions which supplement and extend these provisions to cover specific additional topics.

With regard to the Newark AMC, it was taken off the list in March 2006, but it is on the FY08 AMC consideration list for closure.

The same collective bargaining procedures and articles described above are applicable to any career Postal Service employee employed at one of the AMC targeted for closure. Any reassignments to impacted employees will be made in accordance with agreements made with our employee organizations.

**The following schedule reflects our plan to-date.**

| | Area | Airstop | Location | AMC/F Operation Termination Date |
|---|---|---|---|---|
| | **Article 12 FY07 Working** | | | |
| 1 | Capital Metro | DCA | Washington DC | TBD |
| 2 | Capital Metro | GSO | Greensboro NC | 6/2/2007 |
| 3 | Southeast | BNA | Nashville TN | 6/2/2007 |
| 4 | Southeast | JAX | Jacksonville FL | 6/30/2007 |
| 5 | Southwest | AUS | Austin TX | 6/30/2007 |
| 6 | Northeast | BUF | Buffalo NY | 7/23/2007 |
| 7 | Capital Metro | ORF | Norfolk VA | 7/30/2007 |
| 8 | Northeast | ALB | Albany NY | 7/30/2007 |
| 9 | Northeast | ROC | Rochester NY | 7/30/2007 |
| 10 | Northeast | SYR | Syracuse NY | 7/30/2007 |
| 11 | Southwest | TUL | Tulsa OK | 7/30/2007 |
| 12 | Pacific | SMF | Sacramento CA | 9/20/2007 |
| 13 | Eastern | CLE | Cleveland OH | 9/30/2007 |
| 14 | Eastern | CMH | Columbus OH | 9/30/2007 |
| 15 | Eastern | CVG | Cincinnati OH | 9/30/2007 |
| 16 | Eastern | DAY | Dayton OH | 9/30/2007 |
| 17 | Eastern | SDF | Louisville KY | 9/30/2007 |
| 18 | Pacific | SNA | Santa Ana CA | 9/30/2007 |
| 19 | Southeast | PBI | West Palm Beach FL | 9/30/2007 |
| 20 | Southwest | ABQ | Albuquerque NM | 9/30/2007 |
| 21 | Southwest | OKC | Oklahoma City OK | 9/30/2007 |
| 22 | Western | SLC | Salt Lake City UT | 9/30/2007 |
| 23 | Capital Metro | RIC | Richmond VA | TBD |
| 24 | Southeast | RSW | Fort Myers FL | TBD |
| 25 | Western | RNO | Reno NV | TBD |

| | | | | |
|---|---|---|---|---|
| | **Article 32 FY07 Working (contracted)** | | | |
| 1 | Western | DEN | Denver CO | 7/1/2007 |
| 2 | Great Lakes | DTW | Detroit MI | 9/30/2007 |
| 3 | Great Lakes | IND | Indianapolis IN | 9/30/2007 |
| 4 | Great Lakes | MKE | Milwaukee WI | 9/30/2007 |
| 5 | Northeast | BDL | Hartford CT | 9/30/2007 |
| 6 | Pacific | ONT | Ontario CA | 9/30/2007 |
| 7 | Southwest | IAH | Houston TX | 9/30/2007 |
| 8 | Southwest | SAT | San Antonio TX | 9/30/2007 |
| 9 | Western | LAS | Las Vegas NV | 9/30/2007 |
| 10 | Western | MSP | Minneapolis MN | 9/30/2007 |
| 11 | Western | SEA | Seattle WA | 9/30/2007 |
| | Western | SEA | Seattle WA (North Bldg.) | 9/30/2007 |
| | Western | SEA | Seattle WA (Bldg. G) | 9/30/2007 |
| 12 | Pacific | LAX | Los Angeles CA | FY08 |

| | AMC/F Operations Terminated FY07 | | | |
|---|---|---|---|---|
| 1 | Great Lakes | GRR | Grand Rapids MI | 9/15/2006 |
| 2 | New York Metro | LGA | LaGuardia | 9/15/2006 |
| 3 | Western | ICT | Wichita KS | 9/25/2006 |
| 4 | Capital Metro | CAE | Columbia SC | 9/29/2006 |
| 5 | Eastern | PIT | Pittsburgh PA | 9/29/2006 |
| 6 | Great Lakes | STL | St Louis MO | 9/30/2006 |
| 7 | Western | PHX | Phoenix AZ | 11/4/2006 |
| 8 | Western | MCI | Kansas City MO | 11/11/2006 |
| 9 | Capital Metro | IAD | Dulles VA | 12/31/2006 |
| 10 | Pacific | OAK | Oakland CA | 12/31/2006 |
| 11 | Pacific | SJC | San Jose CA | 12/31/2006 |
| 12 | Western | OMA | Omaha NE | 1/27/2007 |
| 13 | Western | DSM | Des Moines IA | 2/16/2007 |
| 14 | Western | TUS | Tucson AZ | 2/17/2007 |
| 15 | Western | BOI | Boise ID | 3/16/2007 |
| 16 | Western | PDX | Portland OR (AMC Annex) | 3/17/2007 |
| | Western | PDX | Portland OR (AMC Annex) | 3/17/2007 |
| 17 | Capital Metro | CLT | Charlotte NC | 3/17/2007 |
| 18 | Southeast | BHM | Birmingham AL | 3/31/2007 |
| 19 | Southeast | JAN | Jackson MS | 3/31/2007 |
| 20 | Southeast | PNS | Pensacola FL | 3/31/2007 |
| 21 | Southwest | LIT | Little Rock AR | 4/1/2007 |
| 22 | Pacific | SAN | San Diego CA | 4/30/2007 |
| 23 | Capital Metro | GSP | Greenville SC | 4/30/2007 |
| 24 | Southeast | MEM | Memphis TN | 4/30/2007 |
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| 26 | Capital Metro | RDU | Raleigh NC | 5/19/2007 |

9. As Ms. Siggerud noted in her testimony, labor continues to be the Postal Service's largest cost driver. The postal reform bill, as you know, did not give the Postal Service much help in reducing labor costs. We did this, in part, because we believed the Postal Service had the ability to obtain significant labor cost savings through the collective bargaining process. You now have renegotiated contracts in place with the American Postal Workers Union and the National Postal Mail Handler Union. What progress do you believe you've made in these two contracts in controlling labor costs at the Postal Service?

**The recently negotiated collective bargaining agreements with the APWU and the NPMHU both include new wage and benefits provisions that enhance the ability of the Postal Service to address its labor costs. Both contracts contain overall wage increases lower than the expected growth in private sector wages, as well as other labor-cost savings provisions. In particular, the Postal Service and APWU agreed to ease restrictions on the use of lower cost, temporary employees. The Postal Service and the NPMHU negotiated a new starting salary for entry-level mail handlers, significantly below the previous starting wage.**

**In response to the rising cost of health insurance benefits, the new agreements with both the APWU and NPMHU include a 1 percent per year reduction in the employer contribution for health benefits for each year of the contracts.**

10. Another significant cost driver for the Postal Service is transportation. What steps has the Postal Service taken recently to reign in transportation costs? I sought to include language in the postal reform bill changing the manner in which the Postal Service send mail on commercial airlines by giving the Postal Service the ability to negotiate rates rather than having them set by the Department of Transportation. This language was necessary, I was told at the time, because the DOT-set rates were significantly higher than those the Postal Service could obtain in an open market. Is this still a problem? If so, how does the Postal Service waste each year due to the artificially high DOT-set rates?

**The Postal Service has limited ability to manage its international mail air transportation costs. Under current law, the Postal Service generally must pay rates set by the Department of Transportation (DOT) for international mail air transportation, unless the Postal Service can satisfy one of several exceptional requirements. Although the Postal Service has some ability to negotiate rates and has done so through increased use of International Air Transportation contracts, contractual solutions for international air mail transportation are restricted under statute by weight, content, and carrier nationality, thereby significantly limiting their availability.**

**The Postal Service, its ratepayers and the taxpaying public could save a significant amount on transportation costs if we were free to negotiate rates for outbound international mail sent on commercial airlines rather than have those rates set by the DOT. Regulation of these rates by DOT is an anachronism. Rates should be determined by the market economy, not by regulation. Deregulation would save money and promote efficiency. The Postal Service's Office of Inspector General (OIG) has twice issued memoranda endorsing efforts to deregulate international air mail transportation rates. Specifically, the OIG has indicated that the DOT rates place the Postal Service at an unfair disadvantage in the outbound international mail market, and that these rates are one of the restrictions on contracting international mail air transportation that prevents the Postal Service from obtaining optimal prices and service.[1] Similar views were also expressed by the Government Accountability Office, which has recommended that the Postal Service be given the freedom to negotiate**

[1] *See* OIG Memorandum to Thomas G. Day, Senior Vice President, Government Relations, International Mail Air Transportation Rates, May 16, 2007; OIG, *International Mail Air Transportation Rates* (Report Number MS-WP-06-002, dated June 29, 2006).

with carriers for international mail air carriage subject to "appropriate accountability mechanisms."[2]

Our research has consistently shown that DOT rates exceed market rates by considerable margins. For example, a recently conducted analysis by outside consultants reveals that the Postal Service paid between $65 million and $98 million in excess of market rates for total outbound international air transportation for both civilian and military mail. The analysis, based on calendar year 2006 data, examined a range of market rates, from the highest to the most favorable, to project these cost differences.[3]

Deregulation also would level the playing field, a major goal of the recently-enacted Postal Accountability and Enhancement Act. Rate regulation presents a significant competitive disadvantage against foreign postal operators, which have moved into the U.S. outbound-letter market. Foreign postal operators are not subject to DOT rate regulation, and thus the Postal Service cannot fairly compete against them.

In addition, the DOT ratemaking scheme creates little incentive for carriers to provide good service. Allowing for negotiation of outbound international mail air transportation rates would enable the Postal Service to introduce performance-based incentives, based on service. We have introduced performance-based incentives in the contracts for carriers of domestic mail, resulting in lower costs and improved service.

Taxpayers would also benefit from deregulation. Military mail constitutes a large portion of outgoing overseas mail subject to the DOT's regulated rates. By statute, the Department of Defense (DOD) is required to reimburse the Postal Service for the air transportation costs incurred in transporting military mail overseas. Taxpayers thus ultimately bear the burden of paying for excessive rates set under the existing ratesetting procedure. The premium paid by the Postal Service (and reimbursed by the DOD with taxpayer money) for military mail ranges from $24 million to $32 million. Deregulation, accordingly, would significantly advance the public interest. The DOD has indeed expressed its strong support for our position on much needed regulatory reforms before the DOT.

The Administration recently has proposed legislation reauthorizing the Federal Aviation Authority, introduced in the House as H.R. 1356 and in the

[2] Government Accountability Office, International Mail Air Transportation: Proposed Changes to the Ratesetting Process, at 7, 17, April 8, 2005.

[3] In calendar year 2006, the Postal Service spent $194 million for transportation of civilian mail on commercial airlines at DOT-set rates, whereas equivalent market rates ranged between $128 and $153 million, for a difference of $41 to $66 million. That $41 to $66 million represents potential costs savings that could be passed along to Postal Service consumers and businesses.

**Senate as S. 1076. Those bills contain a provision that would terminate, 16 months after enactment, the authority of DOT to set rates to be paid by the Postal Service to U.S. flag carriers for international mail transportation. The Postal Service strongly endorses the Administration's proposal (as embodied in sections 803 and 804 of H.R. 1356 and S. 1076, to deregulate outbound international mail transportation rates and thereby give the Postal Service and air carriers the freedom to negotiate terms, conditions, and price, as is the case with domestic air transportation in the continental U.S.**

# *Questions for the Record: Postal Service Oversight Hearing*
# *Senator Tom Coburn*
# *4/19/2007*

**Mr. John Potter, Postmaster General**

- **5 Years from Now:** One of my biggest concerns regarding the Postal Service isn't what happens now, but what happens five to ten years from now. How do you anticipate postal service in this country changing in the next 5-10 years?

  **There is every reason to believe that current technology and cost trends in our environment will continue well into the future. Technology will continue to present competitive challenges to mail, but it will also provide us with significant new opportunities to improve service and create new customer value. The number of new addresses will continue to grow, as will our health benefit obligations for current employees and future retirees.**

  **Mail will continue to meet the need for affordable, reliable, and universally-accessible hard-copy communications. The strategies in our *Strategic Transformation Plan 2006-2010* are designed to ensure the continuing competitiveness of mail well into the future. Efforts such as the development of Intelligent Mail, the dramatic simplification of business mail acceptance, and access innovations such as the Automated Postal Center, Click-N-Ship and Carrier Pickup are all designed to address emerging needs, and to do so at a level of efficiency and reliability second to none.**

  **The new law reinforces our mission to provide reliable, universal service at affordable rates. It also endorses innovation in postal services and efficiencies in operations. Both are essential to sustaining a viable Postal Service into the future. Of course, our ability to innovate and capture efficiencies will depend on the flexibility we have to adjust products, prices, and networks to evolving markets and customer needs.**

- **[Refer to poster]** Since 2003, the Postal Service's costs have been increasing faster than revenues. By my calculations, if current trends continue, costs will exceed revenues in 2008. Additionally, by 2011, there will be an annual lost of nearly $4 billion.

  - Do you believe that the Postal Reform legislation passed in December will allow the Postal Service to reverse this trend and become more profitable?
  - In your mind, what are the three biggest factors contributing to the slow growth in revenues for the Postal Service?

- Do you think that this problem is one that USPS will have to grow out of (through revenue increases) or trim its way out (with cost-cutting)?

**The opportunity for the Postal Service to improve its revenues and become more profitable under the new postal reform law will depend largely on the flexibility ultimately produced. Assuming that PRC rules provide that flexibility, the law offers mechanisms that will provide modest price changes that reflect changing market and operating conditions, and the ability to customize pricing and realign products to better meet customer needs. The law, however, ignores the expense side of the Postal Service ledger.**

**The slow growth in revenues that we have experienced in recent years is directly attributable to several known factors of our marketing environment: the Postal Service is a mature business, having operated continuously for more than 200 years in its present form; the reality and continuing threat of electronic diversion of mail volumes; the proliferation of new advertising media; and, very effective competitors who have not been regulated as the Postal Service has. None of these influences is likely to lessen.**

**Given this mix of market influences, the Postal Service, as a mature business, must capitalize on growth opportunities where available and trim its way out of the trough in which its expenses exceed its revenues. But, as it cuts costs, the Postal Service must deliver quality services to the public it serves.**

**Along with growth opportunities in traditional mail services, we must carefully consider additional uses of the mail to provide increased services to the public. For example, as is often cited, the Postal Service, with its 33,000 post offices, provides a ubiquitous government presence in the American landscape and, thereby, is best positioned to serve Americans as the bridge to government services, when appropriate. We provide such services now in the processing of passport applications, and we could conceivably offer other such services to the public on behalf of the federal government. We could enhance Voting-by-Mail services and increase its use and associated mail volumes. And, we could provide appropriate new services to state and local governments.**

- **First-Class Mail:** Since 1999, first-class mail volume has declined from 56 billion pieces to 45 billion in 2006. To what degree do you see this problem as one that was caused by management decisions and to what degree is it simply the effects of the market?

- Do you think it will always be necessary for the government to be the sole deliverer of first-class mail, or is this an area that could be opened up to competition like package delivery?
- Will the postal reform legislation reverse the decrease in first-class mail or slow it down? Or, will it have no effect at all?

**First-Class Mail volume was 102 billion pieces in 1999 and just under 98 billion pieces in 2006. First-Class single-piece letter volume declined from just under 54 billion pieces in 1999 to 42 billion pieces in 2006.**

**Although some of this single-piece decline is undoubtedly the result of migration into workshared letters, the driving force underlying the decline has been electronic diversion. This change is not related to postal management decisions.**

**In fact, the Postal Service has kept increases in the price of a First-Class stamp below the rate of inflation during this period, while offering continuous service improvements (33 cents in 1999 compared to 39 cents in 2006). This increase (18 percent) was less than the overall increase in consumer prices (21 percent).)**

**We believe that the Postal Service should remain the sole deliverer of First-Class letters. This will ensure universal delivery of all mail at affordable rates. Of course, the contribution from single-piece letters will have to be replaced by contribution from other postal products. It is best that this transition takes place gradually so that it can be managed without disruption to mail service and dramatic increases in the prices paid by users of other postal products.**

**Since the price of the First-Class stamp has been in line with consumer price inflation, PL 109-435 that caps First-Class-letter rate increases at inflation at the class level is unlikely to materially affect the declining long-term trend in First-Class letter volumes.**

- **Service Standards:** I was troubled to learn that although USPS has established service standards for its products (i.e. – one to three day delivery for first-class mail, etc.), you have never measured whether or not they are even being met. How long will it be until you establish measurement tools for your service standards?
  - How specifically do you plan on measuring your service standards? What will that look like in practice?
  - Why has this never been done before?

**The Postal Service does have service performance measurement systems for some products. We post service performance scores for the Express Mail, Priority Mail, single-piece First-Class Mail, and Parcel Select mail products on our website, www.usps.com.**

**For First-Class Mail, for example, we have measured the quality of delivery service for nearly two decades. First-Class Mail performance is measured externally by an independent firm. This system is called External First-Class Mail measurement, or EXFC. It measures conformance to service standards by recording the time that mail enters the mail stream until it is delivered to a household, business, or Post Office box. EXFC reports performance from a customer perspective and produces accurate, independent, externally-generated results.**

**While EXFC has been quite helpful as a diagnostic for guiding our continuous service improvement for First-Class Mail, a sampling method of this type, and on this scale, is very costly. That cost is built into the price for First-Class Mail. Several years ago we worked with Periodical and Standard Mail users to evaluate a system similar to EXFC. Given the added levels of presort and entry complexity for these classes of mail, as well as the costs being directly attributed to these products, a similar system was not implemented. However, the Postal Service has used less costly internal diagnostic processes, customer feedback through the Business Service Network, and information from customers' own measurement processes to manage and improve service in the interim.**

**The Postal Service's Strategic Transformation Plan, published in 2005, committed to measuring service performance by 2010 for all classes of mail using an advanced barcode that can provide customer-specific information. This technology, called Intelligent Mail, offers a lower-cost way to capture diagnostic information, in real time. It promises to be much less expensive than an externally conducted sampling method such as EXFC because information about the mail is collected during normal automated processing. Second, it measures actual mail, not proxy mail pieces deposited by a vendor. Lastly, it tracks not just a sample of the mailstream; it tracks every mail piece with a barcode. This will give mailers much more information about their own mail without adding significant new infrastructure or new contract expenses.**

**The Postal Service is currently working through the Mailers' Technical Advisory Committee (MTAC) to meet the requirement that market-dominant products have service standards and objective measurement systems. Our customers are supportive of the use of advanced barcode and automation systems to track mail and measure the performance against standards.**

**How service measurement will look in practice will be a focus of the upcoming consultations with the PRC.**

- **Productivity:** You have reported that USPS has increased its productivity by less than 10% in 17 years, despite the vast improvements in technology over that time. How do you explain such a small increase in productivity?

    - What are the two or three biggest factors keeping productivity gains so small?
    - How do you plan on increasing productivity in the face of such obvious challenges as a no-layoff clause, inability to get rid of unneeded post offices and increasing delivery points each year?

  **Since Fiscal Year (FY) 1999, the Postal Service has increased its Total Factor Productivity by 10.4%. This represents seven consecutive years of positive productivity increases and the Postal Service is well on its way to realizing an eighth consecutive year of positive productivity, as productivity through the first half of this fiscal year increased by 1.3%. These sustained productivity increases are unprecedented since the Postal Service was created in its current form in 1971. Additionally, the postal labor force has been reduced by more than 100,000 employees since FY 1999, all through attrition, while the network has grown by approximately 11 million delivery points.**

  **The greatest challenge for the Postal Service from a business perspective is the current business model, which is based on ever-increasing levels of First-Class Mail volume to cover the costs of the expanding network. Due to changes in technology and in the economy, that assumption is no longer valid. First-Class Mail volume has been flat or slightly declining in recent years, and has been overtaken by Standard Mail volume, which has lower levels of contributions towards institutional costs.**

  **The Postal Service is committed to making further advancements in productivity. Cost-control strategies include additional automation, particularly in the processing of flats and increased flexibility gained through the negotiated labor agreements. Our underlying goal is to ensure that the Postal Service can provide affordable universal service today and well into the future.**

- **Labor Costs:** Currently, labor costs are eating up almost **80%** of your annual operating budget, and are growing faster than inflation each year. Do you think that this is a problem too big to fix or is there something you can do to get this problem under control?

    - I am disturbed that the Postal Service is unique in the federal government in having a no-layoff clause. Obviously no one promotes laying good people off, but isn't this a policy that threatens to do more harm than good in the long run?

- What management tools are you lacking now that would help you reign in labor costs?

**Layoff protection for certain bargaining unit employees has been part of the collective bargaining agreements with our largest unions for over 25 years. In spite of these provisions, the Postal Service has managed to increase productivity and reduce the size of its workforce through attrition. Since FY 2000, the total number of career Postal employees has fallen by over 90,000, or about 11.5 percent. Reducing the workforce helps restrain total labor cost.**

**Labor costs themselves grow annually and many components of those costs are not within the Postal Service's control. We are, of course, impacted by increasing costs of providing health care benefits to our employees and retirees. Health-care cost increases continue to outstrip the annual rate of inflation. For the Postal Service, the impact of these growing costs will be compounded by the growth in the number of Postal Service retirees that is anticipated for the coming years.**

**The Postal Service needs all the tools of managerial flexibility to deal with this daunting problem. As personnel costs comprise 80% of our total cost, we must continually seek operational cost reductions and efficiencies to compensate for rising personnel costs**

**Addressing issues specific to Postal Service operations, we need to be able to invest in automation when and where it will reap efficiencies for our business and also allow us to continue to gain efficiencies from attrition. Confronted with mail volumes that are relatively flat, at best, and where the customers are performing more and more of the mail preparation, it is imperative that we have the ability to realign our facilities to manage the new reality of the market and the changing mailstream. To manage these initiatives so that they allow us to maintain service standards while gaining cost and production efficiencies, we need to maintain our current ability to contract out work, consistent with the provisions of our collective bargaining agreements.**

**The Postal Service needs the flexibility to develop approaches to deal with employee and retiree health benefits costs that we are confronting so that we can continue to provide the same high-quality, high-service benefits at reasonable rates.**

**As one example, the Postal Service needs the Medicare Part D employer's subsidy for providing retiree prescription drugs. Under the specific terms of the Medicare Modernization Act, the Postal Service qualifies for this subsidy, which is intended to reduce employers' costs of providing these important retiree health benefits. Employers throughout the country, including Postal Service competitors, are receiving this important cost-reducing subsidy as the Act intended.**

**Post-Hearing Questions for the Record**
**Submitted to Dan G. Blair**
**From Senator Thomas R. Carper**
**"The Road Ahead: Implementing Postal Reform"**

1. A major goal of the postal reform legislation was rate flexibility. We placed a tight rate cap on the Postal Service but intended for them to have as much flexibility under the cap as possible to charge what the market will bear and tailor prices to their own needs and the needs and desires of their customers. How do you plan to ensure that the Postal Service is indeed granted maximum pricing flexibility under the new rate system? What, if any, controls do you think there should be on pricing flexibility other than the CPI cap?

***The Commission takes seriously its role in implementing the Postal Accountability and Enhancement Act (PAEA). That is why we are seeking input from interested parties on establishing a modern system of rate regulation for market dominant and competitive products. We issued an Advance Notice of Proposed Rulemaking on Regulations Establishing a System of Ratemaking (Docket No. RM2007-1) on January 30, 2007. Thirty sets of initial comments were received along with 21 individual reply comments. On May 17, 2007, we issued a Second Advance Notice of Rulemaking so that interested parties could make more specific proposals on pricing flexibility. The Notice details specific issues central to implementing the regulations and seeks comments on how to ensure maximum pricing flexibility as envisioned by the PAEA. We received 20 sets of comments and reply comments in response to this second notice.***

***In addition, the Commission held field hearings in Kansas City, Missouri, Los Angeles, California, and Wilmington, Delaware to ensure that diverse sectors of the mailing community are heard as we develop a modern system of regulations.***

***The comments received to date reinforce the need to maintain flexibility at the class level with some suggestions on how to achieve the worksharing standards established by the Act. I am confident that the Commission's rules will facilitate movement toward an efficient and effective Postal Service as envisioned by the Act without putting any group of mailers at risk. We intend to first establish a broad, transparent framework providing extensive flexibility and discretion to management while monitoring exactly how the flexibility is used, and adjust rules as necessary through time as the Postal Service gains experience with the new pricing policies.***

2. One aspect of pricing flexibility that we explicitly required that the Postal Service be extended is the ability to enter into so-called "Negotiated Service Agreements" with individual mailers or groups of mailers. The idea is that the Postal Service should be free to sit down with their customers and work out arrangements that allow for new volume and new revenue to be brought into the system in exchange for the Postal Service departing somewhat from the normal way they handle mail. There are a number of these agreements in place now and I understand that they've been successful. How do you envision Negotiated Service Agreements working under the new rate system? Do you think there will be any changes to the rules that govern these agreements now?'

***The Commission has recommended five Negotiated Service Agreements (NSAs) which have been approved by the postal Governors. We currently are considering Docket No. MC2007-1 (Bank of America).***

***Section 3622 of the PAEA makes it clear that NSAs are to continue. As noted in my response to your first question, the Commission's Second Advance Notice of Rulemaking specifically asks commenters to consider the design of a modern ratemaking system. The Commission is required to consider 14 factors, including "the desirability of special classifications for both postal users and the Postal Service . . . " which covers Negotiated Service Agreements. The new rules will ensure that new NSAs can be implemented more rapidly than has been the experience under the old Act. What will become more significant is the monitoring by the Commission of the outcome of the NSAs on the basis of Postal Service data on the performance of the NSAs.***

3. As you know, the postal reform bill included a number of rate objectives and factors that the Postal Regulatory Commission is supposed to take into account when developing the new rate system. How do you intend to weigh the objectives and factors both in developing the new system and in reviewing rate changes submitted by the Postal Service once the new system is in effect?

***Congress granted the Postal Service, in the first instance, the obligation to set rates taking into account the requirements, objectives, and factors set forth in the PAEA. Parties providing comments to the Commission have emphasized the primacy of the cap requirement in the review of rate changes submitted by the Postal Service. Achievement of the objectives and factors will be a focus of the Annual Compliance Report and the Annual Report to the President and Congress. In these reports, the Commission will have an opportunity to identify problems and recommend solutions. Likewise, the complaint process may bring to the forefront issues impeding the achievement of the factors and objectives and recommend remedial actions.***

4. The final version of the postal reform bill includes language from the Senate bill allowing the Postal Service to implement rate changes under the new rate system with as little as 45 days notice. I know that the Postal Service intends to give significantly more than 45 days notice in most cases but we believed it was important to give the Postal Service some minimum assurance that they could quickly change prices to meet their needs and the needs of their customers. We intended for the 45-day review period to be used by the Postal Regulatory Commission to review rate proposals for their compliance with the rate cap. How do you envision the Commission doing during the 45-day period should the Postal Service choose in the future to exercise its right to change rates that quickly?

   ***The Commission understands that Congress envisioned timely consideration of rate proposals under the 45-day review period, which underscores the importance of having timely and accurate financial data from the Postal Service. It is our expectation that if the Commission has access to such data then reviewing a rate proposal within 45 days could be accomplished.***

5 One of the concerns that the Postal Service brought to us when we were drafting and negotiating the final postal reform bill dealt with service complaints. I believe they were concerned about being inundated with requests from the Postal Regulatory Commission to provide data and respond to complaints involving internal management decisions service complaints that are not very significant. How do you intend to vet complaints to ensure that those taken up by the Commission do not touch on day-to-day management decisions and focus on significant service problems?

   ***The Commission does not intend the PRC to be a conduit for minor operational complaints. Rather, we will establish a system that focuses on significant national or regional issues and on noncompliance with applicable postal laws. This approach is consistent with the comments from both the Postal Service and mailers in response to our Notices of Proposed Rulemaking.***

**Dan Blair, Chairman, Postal Regulatory Commission**
**Questions for the Record submitted by Senator Tom Coburn**

1. New Oversight Role of PRC: With the reform bill that passed, the Postal Regulatory Commission will have the new role of overseeing USPS' financial data. How do you plan on sharing that data with Congress and the American public to help us understand the agency's financial situation?

   ***The Commission understands the role envisioned by the Postal Accountability and Enhancement Act with regard to overseeing the Postal Service's financial data. We expect to publish the data received on our web site (www.prc.gov) except for information that the Postal Service identifies as sensitive proprietary information. We will issue an Annual Compliance Report analyzing Postal Service data to ensure that annual rate increases are within the rate cap and in compliance with all applicable postal laws.***

   ***We will also seek public comments and issue regulations on USPS accounting practices and principles for competitive products no later than December 2008 or by a time mutually agreeable to the Commission and the USPS. These regulations will be informed by recommendations made by the Secretary of the Treasury that are to be submitted to the PRC no later than December 2007. We may also institute rulemaking to improve the quality, accuracy, or completeness of USPS data.***

2. How do you plan on using your new role as Chairman of the PRC to ensure that the Postal Service keeps citizens as the primary priority?

   ***Transparency and accountability should be the hallmarks of the Commission. We will ensure that citizens and Congress are apprised of the Commission's activities. To achieve these goals we will establish rules of practice to prevent discriminatory actions against citizen mailers, achieve transparency through data requests from the Postal Service that will be analyzed by the Commission and made available on our web site, devise a complaint process, and issue an annual compliance report and an annual performance report to the President and Congress.***

3. Another Rate Case: You have indicated that the USPS should not file another rate case after the current one goes into effect in May. Do you think it is likely that a rate case will be filed anyway?

   ***The Commission will publish new ratemaking regulations this fall which will allow the Postal Service to raise rates under the PAEA thus eliminating the need for a lengthy rate case under the old law. It is my hope that there would not be another rate case***

***under the old law, but the final decision on whether or not to take advantage of the law that allows one more old-style rate case is the responsibility of the Board of Governors.***

4. Why would filing another rate case be a bad idea?

   ***I believe it would be a better use of Postal Service and the Commission resources to focus on effective implementation of the PAEA.***

5. What effect do you think that another rate case far above the Consumer Price Index (CPI) would have on first-class mail volume?

   ***All rate increases reduce volume. This is especially true for First-Class single piece volume which has been decreasing even without rate increases due to alternatives to the U.S. Mail.***

6. Is it typical for the Postal Service to finish one rate case only to turn right around and file another one? Isn't that a pretty inefficient way to do business?

   ***In 2005 and 2006, we had back-to-back rate cases, so it does occur. It definitely strains the resources of the Commission, the Postal Service, and mailers alike.***

7. Financial Situation of USPS: [refer to poster] As the poster shows, USPS is on track to have its costs outpace its revenues in 2008. Do you believe that even with the reform bill passed in December that USPS has a chance to reverse this situation?

   ***The rate changes introduced this spring and summer should allow the USPS to breakeven in 2008. Due to the timing of the enactment of the law, the Commission did not incorporate the impact of the PAEA into its decision recommending these rates since the record was closed at the time of passage. However, the contingency amount recommended by the Commission was greater than the PAEA impact. Even if the impact of unexpected events such as the PAEA exceeds the contingency amount, the excess could be recovered through a CPI increase in rate during 2008, either through the new modern system or a traditional rate case.***

8. How will it be possible for the Postal Service to recover from its current situation if every time it gets in trouble it just raises its rates? Shouldn't it also consider cutting costs?

   ***Understanding how the Postal Service is keeping rates under the CPI while maintaining service standards will be considered by the Commission in its Annual Compliance Report to Congress. We will need timely and accurate data from the Postal Service to make these determinations. Mailers are particularly sensitive to cost cutting efforts that may affect mail delivery. Many of the comments submitted in response to the Commission's Advance Rulemaking Notices have emphasized the relationship between cutting costs without reductions in service.***

9. Do you believe that capping annual rate increases at the Consumer Price Index (CPI) will ultimately help the Postal Service get in shape financially?

   ***The rate cap should certainly help focus the Postal Service on the need to operate efficiently. The Commission is responsible for reporting to the President, Congress, and the general public on progress in this area and making adjustments to the regulatory rules to motivate greater progress. We will do that under our accountability and transparency responsibilities.***

**Additional Questions for the Record**
**For Chairman Dan Blair**
**Postal Regulatory Commission**
**Submitted by Senator Daniel K. Akaka**
**Committee on Homeland Security and Governmental Affairs**
**Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security**

Establishing Service Standards

1. During the hearing, I asked you about the Postal Regulatory Commission's views on consultation between itself and the Postal Service in establishing service standards. Section 3961(a) of the Postal Accountability and Enhancement Act (PAEA) states:

    *(a) Authority Generally.--Not later than 12 months after the date of enactment of this section, the Postal Service shall, in consultation with the Postal Regulatory Commission, by regulation establish (and may from time to time thereafter by regulation revise) a set of service standards for market-dominant products.*

    In the Government Accountability Office's testimony before the subcommittee, they stated that maintaining services "while establishing reliable mechanisms for measuring and reporting performance will be critical to the Service's ability to effectively function in a competitive market and meet the needs of various postal stakeholders..." I believe it makes clear that the development of these service standards must be as thoughtful and thorough as possible.

    In your testimony, the Postal Service stated that they had invited the PRC to sit in on and participate in meetings of the Mailers Technical Advisory Committee (MTAC). You stated that PRC's participation in MTAC meetings is a good first start, but that you believe vigorously and true consultation is yet to take place and things are in their very initial phases.

    A. Does the PRC believe that their current participation in these MTAC meetings satisfies the statutory requirement for consultation as laid out in Section 3961 of the PAEA, regardless of whether you expect to further consult with the Postal Service?

    ***As I noted in my testimony and in response to questions, I believe the Commission's observation of the MTAC meetings that are developing recommendations to the Postal Service on delivery standards is a productive prelude to consultation. However, the invitation to observe in the MTAC***

***meetings does not constitute formal consultation as envisioned by the PAEA nor by the Commission.***

***For that purpose, we have begun a series of meetings between Commissioners and senior postal managers that allow the Commission to consult as the standards development process unfolds. We expect this process to lead up to a written proposal submitted by the Postal Service to the Commission late this summer or early fall regarding service standards and measurement of performance. We will provide feedback on the proposal that will permit consultation on specific proposals prior to publication as drafts in the Federal Register.***

***In addition, to provide a broad basis of input to the Commission, we issued a Notice of Request for Comments on Modern Service Standards and Performance Measurement for Market Dominant Products on June 13, 2007. We also have held field hearings in Kansas City, Missouri, Los Angeles, California, and Wilmington, Delaware to ensure that we hear from diverse sectors of the mailing community as we develop a modern system of regulations.***

B. Did the PRC have an expectation when the MTAC meetings began that there would be consultation beyond participation in these MTAC meetings?

***Yes, the Commission anticipated a formal consultation process with the Postal Service separate from the MTAC meetings. In response to your questions at the hearing, I expressed my view that we expect to see our direct input into the delivery standards promulgated by the Postal Service.***

C. Did the PRC discuss with the Postal Service prior to the MTAC meetings, next steps in the consolation process?

***The Commission has had several briefings from Postal Service officials on various aspects of current Postal Service delivery standards. We also are having meetings with the Deputy Postmaster General, the USPS General Counsel, and others with the mutual understanding that additional meetings would occur over the next few months.***

***Responses to Post-Hearing Questions for the Record***
***The Road Ahead: Implementing Postal Reform - April 19, 2007 Hearing***
**Subcommittee on Federal Financial Management, Government Information, Federal Services and International Security**
**Committee on Homeland Security and Governmental Affairs**
**United States Senate**

**Questions for Katherine Siggerud, Director**
**Physical Infrastructure Issues**
**U.S. Government Accountability Office**

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**Question for the Record Submitted by Senator Coburn**

1. **Real Property: You all have done a lot of work examining the Postal Service's real property portfolio and feel that they could stand to downsize both its post offices and its distribution centers. Where do you see the most bang for the buck - downsizing the unneeded post offices or going after the distribution centers?**

We have not conducted a specific analysis of the savings that the Postal Service could realize by reducing unneeded or obsolete retail and processing facilities from its nationwide network of about 32,000 retail post office facilities and 670 processing and distribution facilities. As we testified in November 2003 (GAO-04-108T), we agree with suggestions made in the 2003 report by the President's Commission on the United States Postal Service that centered on standardizing and streamlining the postal network, both the processing and distribution infrastructure and retail facilities, with major efficiency gains possible from changes in the processing and distribution networks. The report stated that, "While a substantial portion of the savings and streamlining of the nation's postal network will occur on the back-end logistics side of postal operations, the Postal Service today also needs to constructively address the fact that many of the nation's post offices are no longer necessary to fulfillment of its universal service obligation, given the proliferation of alternate retail access points in grocery stores, drug stores, ATMs and other more convenient locales in communities across the country."[1]

2. **What are the biggest obstacles that the Postal Service faces in getting its real property portfolio under control? How much of the problem is Congress?**

The Postal Service—like federal agencies—faces a myriad of obstacles and challenges related to managing its facilities. As the third largest landholder in the federal government with a physical presence in virtually every U.S. community, its facility-related challenges may be even more acute than its counterparts. We are currently examining issues related to three key challenges faced by the Postal Service

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[1]President's Commission on the United States Postal Service, *Embracing the Future: Making the Tough Choices to Preserve Universal Mail Service*, (Washington, D.C.: July 31, 2003, p. 81).

and expect to issue a report on our findings in the fall of 2007. The three key challenges relate to (1) capturing and maintaining accurate data on postal facilities, (2) locating facilities consistent with the Service's operational needs, and (3) adequately maintaining the condition of postal facilities. Related to this, we are also examining the Service's actions to address each of these challenges as well as the extent to which its efforts have helped the Service overcome these three challenges. In a separate engagement, we are reviewing challenges related to the Postal Service's realignment and consolidation of its mail processing facilities. Our report on this topic is expected in June 2007.

Postal facility closures have often been controversial on account of employee, community, and congressional interests. In 1976, the Congress amended the Postal Reorganization Act and established specific requirements for the Service when attempting to close a post office, including requirements that the Service consider (1) the effects on the community served, (2) the employees of a facility, and (3) the economic savings to the Service that would result from the closure . The amendment also called for community input and established an appeals process for independently reviewing decisions to close or consolidate post offices. By law, the Service must also provide a maximum degree of effective and regular services to rural areas, communities, and small towns where post offices are not self-sustaining. Thus, the Service cannot close a small post office solely for operating at a deficit. In addition, the Congress often provides direction to the Service through its annual appropriation bills.

As part of its efforts to rationalize ("right size") its network of facilities, the Postal Services' 2002 Transformation Plan indicated that the Service intended to urge Congress to either repeal administrative notice and appeal procedures mandated for closing post offices or replace them with more flexible procedures. In addition, according to the plan, the Service intended to ask Congress to refrain from adding amendments to the Service's annual appropriations bills that discourage post office closings and freeze service level at 1983 levels. While the plan indicates that such actions were needed to provide greater flexibility to adapt and change, it is unclear whether, and to what extent, these initiatives have been pursued, or what effect they might have.

**3. Do you think that the Service's process for assessing the expected and actual savings and benefits from its proposed facility consolidations is sufficient?**

In a report that we plan to issue in June 2007, we discuss the Service's process for assessing the expected and actual results, including cost savings and other benefits, from its proposed area mail processing (AMP) consolidations. One of our concerns discussed is the lack of consistent data that the Service used in developing its analysis of impacts and savings for proposed AMP consolidations and the post-implementation evaluations that have taken place over the past 2 years. These data deficiencies could result in some foreseeable impacts going unnoticed and limit the Service's ability to accurately determine the expected and actual cost savings from its AMP consolidations. Another concern we raised in our report is that the Service does not evaluate impacts to delivery performance, so there is no way to determine the actual impact that AMP consolidations are having on delivery service. The Service's limitations in measuring delivery performance are further detailed below.

4. **Service Performance Standards: GAO has reported that delivery standards are outdated for major types of mail. What delivery standards are outdated? Why is it important that these delivery standards be modernized?**

We have reported that delivery standards are outdated for Standard Mail, Periodicals delivered outside the local area from which they are mailed, and most Package Services.[2] These standards are outdated because they have not been systematically updated in many years and do not reflect USPS's operations or intended service. These standards are loosely based on distance and have tended to remain static despite changes in USPS networks, operations, and operational priorities. For example, the delivery standards for Standard Mail, USPS's largest volume mail category (48 percent of mail volume), were established in the 1970s and are generally based on distance. These standards do not take into account mailer activities, such as presorting mail to the ZIP Code or carrier delivery route level, and entering mail at a postal facility that generally is closer to the destination, that have led to changes in USPS's mail processing and transportation networks. Such activities became much more prevalent after USPS began providing discounts to mailers for these activities more than 25 years ago. Depending on these activities, mail can be delivered faster than the standard.

We have recommended that the Postmaster General take actions to modernize delivery standards for all major types of mail so that they reflect USPS operations and can be used as benchmarks for understanding and measuring delivery performance. It is important that standards be modernized because outdated standards are unsuitable as benchmarks for setting realistic expectations for timely mail delivery, measuring delivery performance, or improving service, oversight, and accountability. For example, reliable and predictable delivery of advertising mail helps businesses efficiently schedule staff and inventory to respond to fluctuations in demand. Anticipating the level of inventory has become more important over time with the trend toward just-in-time inventory that helps minimize storage and financing costs. However, the delivery standards for Standard Mail are not adequate for advertisers to set realistic expectations for mail delivery, in part because these standards do not reflect some operational policies and practices that can lead to mail being delivered faster or slower than the standards call for.

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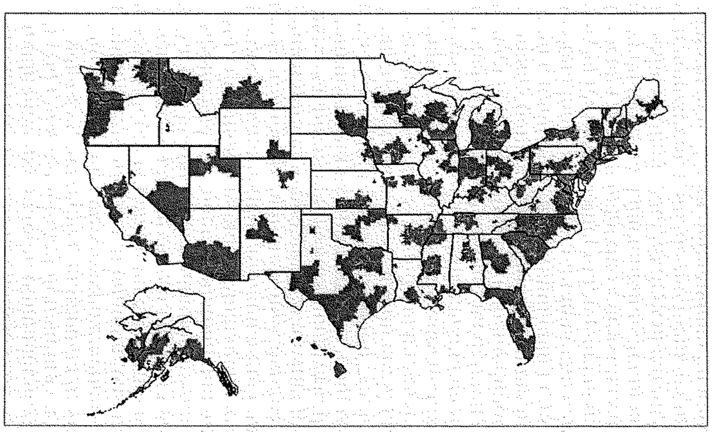
[2]GAO, *U.S. Postal Service: Delivery Performance Standards, Measurement, and Reporting Need Improvement*, GAO-06-733 (Washington, D.C.: July 27, 2006).

**5. Concerns have been raised about the quality of delivery service. However, it can be difficult to understand if these concerns reflect isolated or systemic problems. How adequate is the current information that the Postal Service collects about timely delivery service? Are there gaps, and if so, in what specific areas is more information needed?**

We have reported that USPS measurement of delivery performance is inadequate. USPS does not measure delivery performance for most types of mail.[3] Less than one-fifth of total mail volume is measured. No representative measures of delivery performance—measures that can be generalized to an entire class or major type of mail—exist for Standard Mail (48 percent of volume), bulk First-Class Mail (25 percent of volume), Periodicals (4 percent of volume), and most Package Services (less than 1 percent of volume).[4] In addition, measurement of single-piece First-Class Mail is limited to such mail deposited in collection boxes in selected areas of the country (see fig. 1).

Figure 1: Geographic Coverage of Delivery Performance Measurement for First-Class Mail Deposited in Collection Boxes



Source: USPS.

Note: Areas covered by delivery performance measurement are shaded. Boundaries within states are for 3-digit ZIP Code areas.

As a result of information gaps, USPS and mailers are hindered in identifying and diagnosing delivery problems so that corrective action can be implemented. This increases the financial risk to USPS, which faces increasing competition. If mailers are not satisfied with USPS's delivery service, they could take their business elsewhere.

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[3]GAO-06-733.

[4]Standard Mail is mainly bulk advertising and direct mail solicitations, bulk First-Class Mail includes mail such as bills and advertising, Periodicals are mainly magazines and local newspapers, and Package Services include items such as parcels, merchandise, catalogs, media mail, library mail, and books.

In addition, stakeholders cannot understand delivery performance results and trends, nor can they understand how well USPS is fulfilling its basic mission, including assessing the extent to which USPS is meeting its statutory requirements to provide prompt and reliable service to patrons in all areas of the United States. Deficiencies in measurement, combined with deficiencies in reporting discussed below, also impair oversight and accountability by the Postal Regulatory Commission and Congress. Accordingly, we have recommended that USPS implement representative delivery performance measures for all major types of mail.

**6. How adequate is the Postal Service's reporting of delivery performance information that it does collect? Is more transparency needed in this area, and if so, why?**

We have found deficiencies in USPS reporting of the delivery performance information that it does collect.[5] USPS's reporting of delivery performance information has not adequately met information needs for congressional oversight purposes and has fallen sort of statutory requirements to include specified delivery performance information. Notably, USPS's practices for reporting delivery performance information in its annual *Comprehensive Statement on Postal Operations* fall short of the longstanding requirement in 39 U.S.C. §2401(e) for "data on the speed and reliability of service provided for the various classes of mail and types of mail service." This requirement was enacted due to "the need for effective oversight of postal operations to ensure that the postal services provided the public shall continue at an effective level and at reasonable rates."[6] Specifically, USPS has not included data on the speed and reliability of any entire class of mail in this annual report.

Moreover, we found deficiencies in USPS practices for reporting delivery performance information in USPS reports required by the Government Performance and Results Act (GPRA) of 1993. Specifically, our 2006 report found that USPS's GPRA report included in its *2005 Comprehensive Statement on Postal Operations* provided delivery performance targets (also referred to as performance goals) and results only for single-piece First-Class Mail deposited in collection boxes in selected areas. Results for this mail are generated by the External First-Class Measurement System (EXFC). However, the EXFC results were provided only at the national level, with little accompanying explanation. For example, USPS reported that 87 percent of 3-day EXFC mail was delivered on-time in fiscal year 2005, which did not meet its GPRA target of 90 percent. USPS did not explain, as required by GPRA, why it did not meet its specific target was not met. USPS also did not explain whether it considered the 90-percent goal—which remained unchanged—impractical or infeasible, or, alternatively, what plans USPS had for achieving this goal. Similarly, USPS's GPRA reporting included in its *2006 Comprehensive Statement on Postal Operations*, did not explain, as required by GPRA, why it did not meet its specific target for 2-day EXFC mail. (USPS set a target of 92 percent for this mail and achieved 91 percent.)

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[5] GAO-06-733.

[6] H.R. Rep. No. 94-1444, at 14 (1976).

Although USPS recently added a section on domestic delivery performance to its Web site,[7] it does not provide complete performance information for some types of mail. First, the performance results cover only the most recent quarter, although results for some types of mail have varied by 7 percentage points or more from one quarter to another within the same fiscal year. Second, quarterly results for specific geographic areas also are not included, although USPS collects such results. Third, the limited scope of measurement for some results posted on this section of USPS's Web site is not fully disclosed.

More transparency is needed in this area. As noted previously, without more complete reporting of delivery performance information, Congress and the American public do not have adequate information to determine how well USPS is accomplishing its mission of providing prompt and reliable delivery services. Accordingly, we have recommended that USPS improve the transparency of delivery performance standards, measures, and results by publicly disclosing more information, including in its *Comprehensive Statement on Postal Operations* and other annual performance reports to Congress, as well as providing easily accessible information on its Web site.

[7] http://www.usps.com/serviceperformance/.