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U.S. POSTAL SERVICE

Key Reasons for Postal Reform

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

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Highlights

Highlights of GAO-04-565T, a statement for the record for the Senate Committee on Governmental Affairs and the House Committee on Government Reform

Why GAO Did This Study

Both the Presidential Commission on the U.S. Postal Service and GAO's past work have reported that universal postal service is at risk and that reform is needed to minimize the risk of a significant taxpayer bailout or dramatic postal rate increases. The administration has also supported comprehensive postal reform.

Recent congressional hearings have highlighted broad consensus on the need for postal reform among diverse stakeholders that include the Postal Service, postal employee organizations, the mailing industry, and Postal Service competitors. GAO has also testified in detail about the need for postal reform.

In light of these developments, GAO was asked to briefly summarize the need for postal reform and elements that should be addressed by postal reform legislation. This statement for the record is based on prior GAO reports and testimonies.

www.gao.gov/cgi-bin/getrpt?GAO-04-565T.

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

March 23, 2004

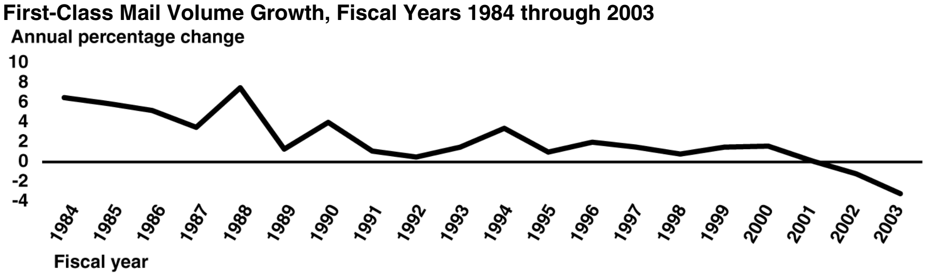
U.S. POSTAL SERVICE

Key Reasons for Postal Reform

What GAO Found

Comprehensive postal reform is urgently needed. The Postal Service's financial viability is at risk because its business model—which relies on mail volume growth to cover the costs of its expanding delivery network—is not aligned with 21st century realities. Financial, operational, governance, and human capital challenges threaten the Service's ability to remain self-supporting while providing affordable, high-quality, and universal postal service. Key trends that demonstrate the need for reform include declining mail volume, particularly for First-Class Mail; changes in the mail mix from high-margin to lower-margin products; increased competition from private delivery companies; and subpar revenue growth. Moreover, the Service continues to have significant financial liabilities and obligations (e.g., retiree health obligations), uncertain funding for emergency preparedness, challenges to achieving sufficient cost-cutting, renewed difficulties in substantially improving postal productivity, and uncertainties regarding the adequacy of capital investment. Thus, the Service's transformation efforts and financial outlook continue to be on GAO's High-Risk List.

First-Class Mail Volume Growth, Fiscal Years 1984 through 2003



Source: Postal Service.

The Postal Service is taking actions within its existing authority to make incremental progress toward transformation, but these steps cannot resolve the fundamental issues associated with the Service's current business model. To avoid the risk of a significant taxpayer bailout or dramatic increases in postal rates, Congress should enact comprehensive postal reform legislation that addresses the Service's key structural and systemic deficiencies, including its unfunded obligation for retiree health benefits and the escrow requirement. It is important that Congress act before the Service faces a crisis that could limit congressional options, particularly because it will take time for the Service to implement major changes.

In GAO's view, specific elements of comprehensive postal reform legislation should address the following: clarify the Service's mission and role; enhance the Service's governance, transparency, and accountability; improve flexibilities and oversight; and make needed human capital reforms.

Chairman Collins, Chairman Davis, and Members of the Committees:

We are pleased to have the opportunity to comment on the need for postal reform and elements that should be addressed by postal reform legislation. This statement is based on our prior work.[1] First, comprehensive postal reform is urgently needed. The Postal Service's financial viability is at risk because its business model—which relies on mail volume growth to cover the costs of its expanding delivery network—is not aligned with 21st century realities. Financial, operational, governance, and human capital challenges threaten the Service's ability to remain self-supporting while providing affordable, high-quality, and universal postal service. Thus, the Service's transformation efforts and financial outlook continue to be on our High-Risk List. Second, specific elements of comprehensive postal reform legislation should address the following: clarify the Service's mission and role; enhance the Service's governance, transparency, and accountability; improve flexibilities and oversight; and make needed human capital reforms.

The Need for Postal Reform

The Postal Service is taking actions within its existing authority to make incremental progress toward transformation, but these steps cannot resolve the fundamental issues associated with the Service's current business model. To avoid the risk of a significant taxpayer bailout or dramatic increases in postal rates, Congress should enact comprehensive postal reform legislation that addresses the Service's key structural and systemic deficiencies, including its unfunded obligation for retiree health benefits and the escrow requirement established by P.L. 108-18.[2] It is important that Congress act before the Service faces a crisis that could limit congressional options, particularly because it will take time for the Service to implement major changes. The following key trends demonstrate that postal reform legislation is needed:

[1] See U.S. General Accounting Office, *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: Bold Action Needed to Continue Progress on Postal Transformation*, GAO-04-108T (Washington, D.C.: Nov. 5, 2003).

[2] The Postal Civil Service Retirement System Funding Reform Act of 2003 (P.L. 108-18), enacted in April 2003, required that, beginning in fiscal year 2006, the difference between the Service's contributions under new and old funding methods—the "savings"—be held in an escrow account until the law is changed.

- *Declining mail volume:* Total mail volume declined in fiscal year 2003 for the third year in a row—a historical first for the Service, which has depended on rising mail volume to help cover rising costs and mitigate rate increases. First-Class Mail volume declined by a record 3.2 percent in fiscal year 2003 and is projected to decline annually for the foreseeable future as customers increase their use of electronic alternatives for communications and payments. This trend is particularly significant because First-Class Mail covers more than two-thirds of the Service's institutional costs.

- *Changes in the mail mix:* The Service's mail mix is changing as the volume for high-margin products, such as First-Class Mail, declines and the volume of lower-margin products, such as some types of Standard Mail, increases. These changes reduce the revenues available to cover the Service's institutional costs.

- *Increased competition from private delivery companies:* Private delivery companies dominate the market for parcels greater than 2 pounds and appear to be making inroads into the market for small parcels. Once a highly profitable growth product for the Service, Priority Mail volume is declining as the highly competitive parcel market turns to lower-priced ground shipment alternatives. Priority Mail volume fell 13.9 percent in fiscal year 2003 and has declined nearly 30 percent during the last 3 years. Express Mail volume is also declining for the same reason. In addition, United Parcel Service (UPS) and FedEx have established national retail networks through UPS's acquisition of MailBoxes Etc., now called UPS Stores, and FedEx's recent acquisition of Kinko's.

- *Subpar revenue growth:* The Service's revenues are budgeted for zero growth in fiscal year 2004, which would be the first year since postal reorganization that postal revenues have failed to increase. However, as the Service has recognized, even this target will be a challenging one. In the absence of revenue growth generated by increasing volume, the Service must rely more heavily on rate increases to cover rising costs and help finance capital investment needs.

- *Significant financial liabilities and obligations:* Despite the passage of legislation that reduced the Service's pension obligations, the Service has about $88 billion to $98 billion in liabilities and obligations, including $47 billion to $57 billion in unfunded retiree health benefits. Under the current pay-as-you-go system, the Service may have difficulty financing its retiree health benefits obligation in the future if mail volume trends continue to affect revenues while costs continue to rise. The Service has recently proposed two options to Congress so the Service can begin to prefund this obligation to the extent that it is financially able.

- *Uncertain funding for emergency preparedness:* The Service requested $350 million for emergency preparedness for fiscal year 2004, which it did not receive, and $779 million for fiscal year 2005. If no funds are appropriated, such funding may have to be built into postal rates.

- *Challenges to achieve sufficient cost-cutting:* The Service achieved additional cost-cutting to compensate for below-budget revenues in fiscal year 2003. Despite this progress, in the longer term it is unclear whether continued cost-cutting efforts can offset declines in First-Class Mail volume without affecting the quality of service.

- *Renewed difficulties in substantially improving postal productivity:* The Service's productivity increased by 1.8 percent in fiscal year 2003 but is budgeted to increase by only 0.4 percent in fiscal year 2004. In the absence of mail volume growth, substantial productivity increases will be required to help cover cost increases generated by rising wages and benefit costs and to mitigate rate increases.

- *Uncertainties regarding the adequacy of capital investment:* The Service's capital cash outlays declined from $3.3 billion in fiscal year 2000 to $1.3 billion in fiscal year 2003, which was the lowest level since fiscal year 1986. Looking forward, it is unclear what the Service's needs will be for maintaining and modernizing its physical infrastructure, as well as whether its plans for capital investment will be adequate for transformation.

Key Areas for Postal Reform

Key areas of the Service's statutory framework that need to be addressed include:

- *Mission and Role:* Congress needs to (1) define the scope of universal service and the postal monopoly and (2) clarify the Service's role with regard to competition and regulation.

- *Governance, Transparency, and Accountability:* Congress should (1) delineate public policy, operational, and regulatory responsibilities; (2) ensure managerial accountability through a strong, well-qualified corporate-style board that holds its officers responsible and accountable for achieving real results; and (3) define appropriate reporting mechanisms to enhance the Service's transparency and accountability for financial and performance results.

- *Flexibility and Oversight:* Congress needs to balance increased flexibility for the Service—through streamlining the rate-setting process and allowing a certain amount of retained earnings—with appropriate oversight by an independent regulatory body to protect postal customers against undue discrimination, restrict cross-subsidies, and ensure due process. In addition, the Service needs additional flexibility to rationalize its infrastructure and reshape its workforce. Any such additional flexibility should be accompanied by appropriate safeguards to prevent abuse, along with mechanisms for enhanced transparency and accountability.

- *Human capital reforms:* Congress needs to (1) determine the Service's responsibility for pension costs related to military service, funding retiree health benefits, and determine what action to take on the escrow account established in recent pension legislation; (2) decide whether postal workers' compensation benefits should be on par with those in the private sector; and (3) clarify pay comparability standards.

Contact and Acknowledgments

For further information regarding this statement, please contact Mark L. Goldstein, Director, Physical Infrastructure Issues, at (202) 512-2834 or at goldsteinm@gao.gov. Individuals making key contributions to this statement included Teresa Anderson, Gerald P. Barnes, Margaret Cigno, Kathleen A. Gilhooly, and Kenneth E. John.

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