



Testimony

Before the Subcommittee on the Postal Service
Committee on Government Reform
House of Representatives

Not to be Released
Before
10:00 a.m. EDT
Thursday
October 21, 1999

U.S. POSTAL SERVICE

Challenges to Sustaining Performance Improvements Remain Formidable on the Brink of the 21st Century

Statement by Bernard L. Ungar
Director, Government Business Operations Issues
General Government Division



G A O

Accountability * Integrity * Reliability

U.S. Postal Service: Challenges to Sustaining Performance Improvements Remain Formidable on the Brink of the 21st Century

The Postal Service may be nearing the end of an era. During the past 5 years, the Service has made notable improvements in its financial position and delivery performance. The Service has recorded positive net income and has maintained or improved the overall delivery of certain specific classes of mail. However, the Service expects declines in its core business in the coming years. The growth of the Internet, electronic communications, and electronic commerce has the potential to substantially affect the Service's mail volume. As a result, the Service may experience growing difficulty in maintaining its position in a dynamic communications and delivery environment. These developments make it imperative for the Service to resolve long-standing performance challenges, which involve four major areas.

- Maximize performance: The Service's ability to maximize performance in the face of increasing customer demands and choices calls for establishing processes to accurately assess performance results and collecting and maintaining reliable data to support such assessments.
- Manage employees: The Service's management of employees, its greatest asset, will in large part involve continued attention to labor-management relations problems that have plagued the Service and its unions and management associations for several years.
- Maintain financial viability: The extent to which the Service can maintain financial viability by controlling costs and enhancing revenues will involve appropriately managing its capital investments in technology and infrastructure as well as working to improve productivity.
- Adapt to competition: The means by which the Service can adapt to a rapidly changing communications environment of growing competition will involve positioning the organization to meet changing customer needs, improve performance, and operate more efficiently.

GAO is also highlighting the need for the Postal Service to take action to address long-standing issues related to the quality of data used in ratemaking and recommending that the Postmaster General report to congressional oversight subcommittees on the actions taken and planned in this area.

In recent years, the Service has progressed in addressing various challenges and is continuing to initiate significant changes that respond to the challenges. However, as the Service stands on the brink of the 21st century, time appears to be growing short for the Service to successfully address its challenges so that it can sustain and improve current performance levels and remain competitive in a rapidly changing communications environment.

U.S. Postal Service: Challenges to Sustaining Performance Improvements Remain Formidable on the Brink of the 21st Century

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to participate in the Subcommittee's oversight hearing on the U.S. Postal Service. In my testimony, I shall provide an overview of where the Service stands today, as we come to the end of the 20th century, by looking back at trends in its financial and service delivery performance and also looking forward to the major challenges confronting the Service at the start of a new millennium. Also, I will discuss ongoing work and work that we have completed since June 1998 related to four major challenges facing the Postal Service:

- maximizing performance in the face of increasing customer demands and choices;
- managing employees, the Service's most valuable asset, to maximize attainment of agency goals and continuous improvement of employee performance;
- maintaining financial viability by controlling costs and enhancing revenues; and
- positioning the organization to adapt to a rapidly changing communications and delivery environment with a growing number of competitors.

I will also discuss other major postal oversight issues related to work that we have completed during the past year. A list of the reports and testimonies we have issued since June 1, 1998, is included in the attachment to this statement.

Overview of Financial and Service Delivery Performance

The Service has continued to report improvements in the areas of financial and service delivery performance and has undertaken a number of initiatives to respond to the four major challenges that we identified. Given the nature and extent of the challenges facing the Service, we understand that it will take time to implement and assess the impact of major initiatives intended to address the challenges. And, although the Service has made progress and is continuing to make significant changes, time appears to be growing short for the Service to successfully address these challenges so that it can sustain and improve current performance levels and remain competitive into the 21st century.

The Impact of Increasing Competition

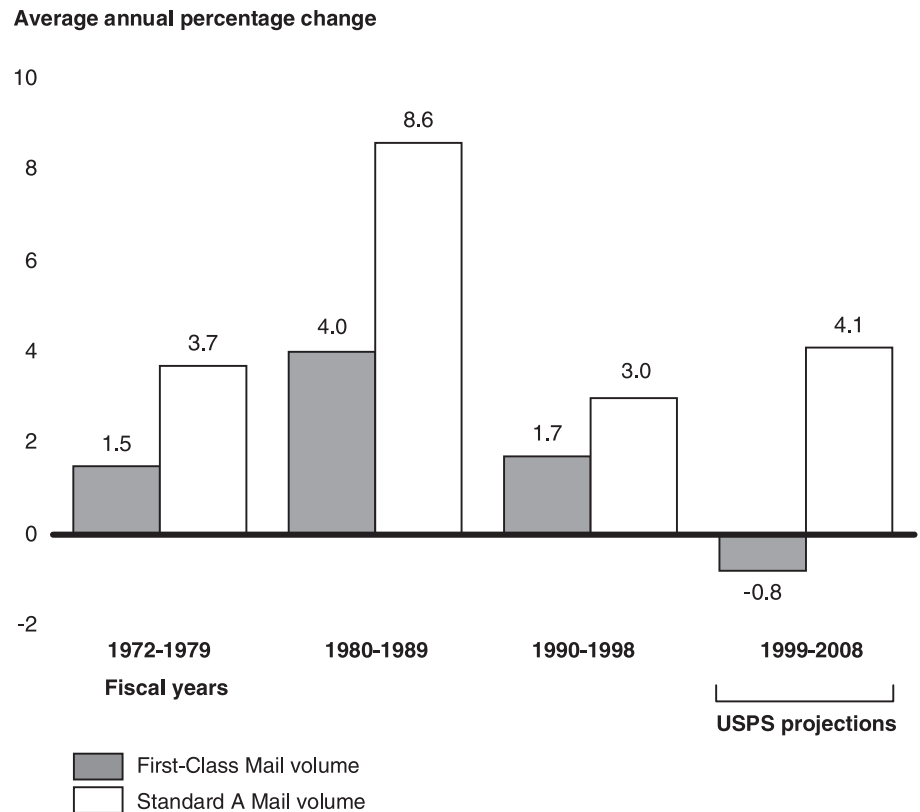
The Service faces growing challenges from competition, notably from private delivery companies and electronic communications alternatives such as the Internet. The Service projects that such competition will lead to substantial declines in the Service's First-Class Mail volume in the next decade. Should this occur, the Service will likely face unprecedented challenges as it seeks to fulfill its primary mission of providing universal postal service at reasonable rates while remaining self-supporting from postal revenues.

The Service and other stakeholders agree that growth in the Service's core business of delivering First-Class Mail has already been affected by the rapid growth of the Internet, electronic communications, and electronic commerce. Although the Service's mail volume increased in the 1990s to record levels, the rate of growth has slowed. As figure 1 indicates, the Service projects that First-Class Mail volume will decline at an average annual rate of 0.8 percent in fiscal years 1999 to 2008. Specifically, First-Class Mail is projected to grow at an average annual rate of 1.8 percent in fiscal years 1999 to 2002—the projected peak—and then to decline at an average annual rate of 2.5 percent in fiscal years 2003 to 2008. Such a decline would be unprecedented in the Service's history and would likely create financial and performance challenges. As the Postmaster General has noted, the Service's environment is changing rapidly, and therefore the Service cannot predict precisely when or to what extent competitive pressures may affect the Service's revenues.

Statement

U.S. Postal Service: Challenges to Sustaining Performance Improvements Remain Formidable on the Brink of the 21st Century

Figure 1: U.S. Postal Service Projects Future Decline in First-Class Mail Volume



Note 1: The U.S. Postal Service forecasts First-Class Mail to increase by an average annual rate of 1.8 percent in fiscal years 1999 through 2002 and to decline by an average annual rate of 2.5 percent in fiscal years 2003 through 2008. The Service also forecasts Standard A mail to increase by an average annual rate of 5.3 percent in fiscal years 1999 through 2002 and to increase by an average annual rate of 3.3 percent in fiscal years 2003 through 2008.

Note 2: Actual data for fiscal year 1999 are not yet available. Standard A mail is primarily advertising mail and includes letters, flats, and parcels that are not sent by First-Class Mail or Priority Mail.

Source: U.S. Postal Service.

Historically, increases in mail volume—including the volume of First-Class Mail—have helped the Service cover its costs. In the 1990s, increasing postage rates and mail volume helped provide the Service with additional revenue to finance wage increases, modernization efforts, and improvements in the quality of delivery service. The Service projects that total mail volume will continue to increase from fiscal years 2000 through 2008 by an average annual rate of 1.7 percent, with the growth rate tapering off during the decade and total mail volume peaking in fiscal year 2006.

Even if total mail volume increases, a decline in First-Class Mail volume would present the Service with the challenge of making corresponding reductions in the costs of handling First-Class Mail—that is, in costs that historically have varied directly or indirectly with changes in First-Class Mail volume—in order to hold down First-Class rates. Further, in fiscal year 1998, revenues from First-Class Mail covered about two-thirds of the Service’s institutional costs.¹ A substantial reduction in First-Class Mail volume would reduce its contribution to institutional costs, which could lead to somewhat higher postage rates in the future.

The Service recently provided us with a detailed explanation of its volume forecast scenario and why it projects a substantial decline in First-Class Mail in the next decade. The Service’s Chief Financial Officer wrote us on September 9, 1999, that First-Class Mail volume is projected to decline on the basis of the assumption that diversion of mail to electronic communications alternatives would accelerate in a new and vastly different environment in which the Service would operate. In this environment, changes in technology and business would create a climate in which current hypotheses about mailing behavior may no longer hold. Notably, the combination of consumer movement to alternative bill payment methods and the consolidation in the financial sector would reduce the number of bills, statements, and payments in the mail stream. Moreover, the movement of advertisers to the Internet would cause a slowdown in the growth of Standard A mail, while growth in Priority Mail and Parcel Post would continue to be robust as consumers embrace electronic commerce and more packages are shipped by Internet retailers. Specifically, the Service’s forecast was based on the following assumptions:

- Potential Year 2000-related complications are largely avoided, increasing business and consumer confidence in electronic alternatives to traditional mail-based bill and statement streams.
- Businesses increase research and development and technology spending as a result of the easy Year 2000 transition, resulting in rapid implementation of on-line banking and financial applications and the spread of Internet-based small business Electronic Data Interchange.

¹Institutional costs do not vary by changes in mail volume, such as costs to maintain a national network of over 38,000 post offices and postal facilities and to deliver to 130 million addresses 6 days a week.

Statement

U.S. Postal Service: Challenges to Sustaining Performance Improvements Remain Formidable on the Brink of the 21st Century

-
- First-Class letter advertising reaches a saturation point because of consolidation in the banking sector, as well as the diversion of bills and payments away from the mail stream.
 - Advertisers move away from traditional media to Internet-based platforms because of increased consumer use of the Internet.

Another key development has been the globalization of the Service's competitors in the delivery sector, which has contributed to recent declines in the Service's international mail volume. Further, the Service's competitors have charged that the Service is using its governmental status to compete unfairly. These developments have fueled the debate over whether the Service should be allowed to introduce new nonpostal products in competition with the private sector, or whether the Service should be limited to offering traditional postal services and wind down its operations as its core business declines. Regardless of how this public policy debate is resolved, the Service has recognized that it must continue to meet customer needs, improve its performance, and operate more efficiently in order to be successful in an increasingly competitive environment.

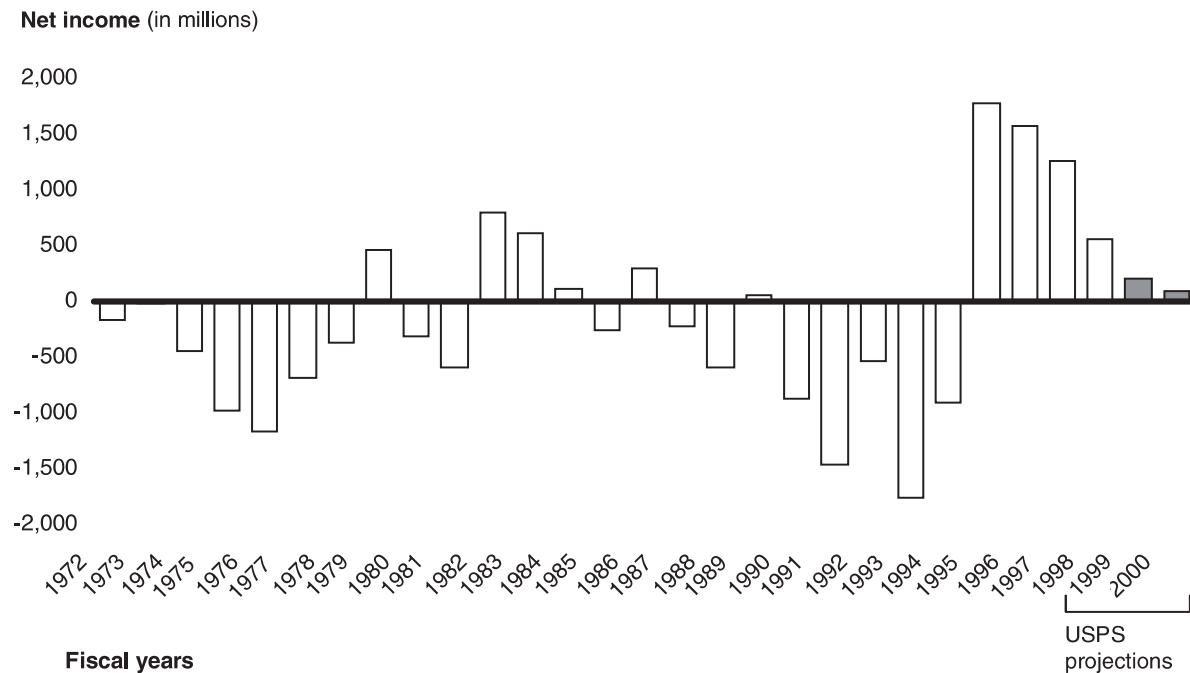
**Financial and Delivery
Performance Continues to
Show Positive Results**

The Service projects positive results for both financial and service performance for fiscal years 1999 and 2000. As shown in figure 2, the Service projects a net income of \$200 million in fiscal year 1999, and its Integrated Financial Plan for fiscal year 2000 projects a net income of \$100 million.

Statement

U.S. Postal Service: Challenges to Sustaining Performance Improvements Remain Formidable on the Brink of the 21st Century

Figure 2: Trends in Postal Service Net Income Since Postal Reorganization Was Implemented



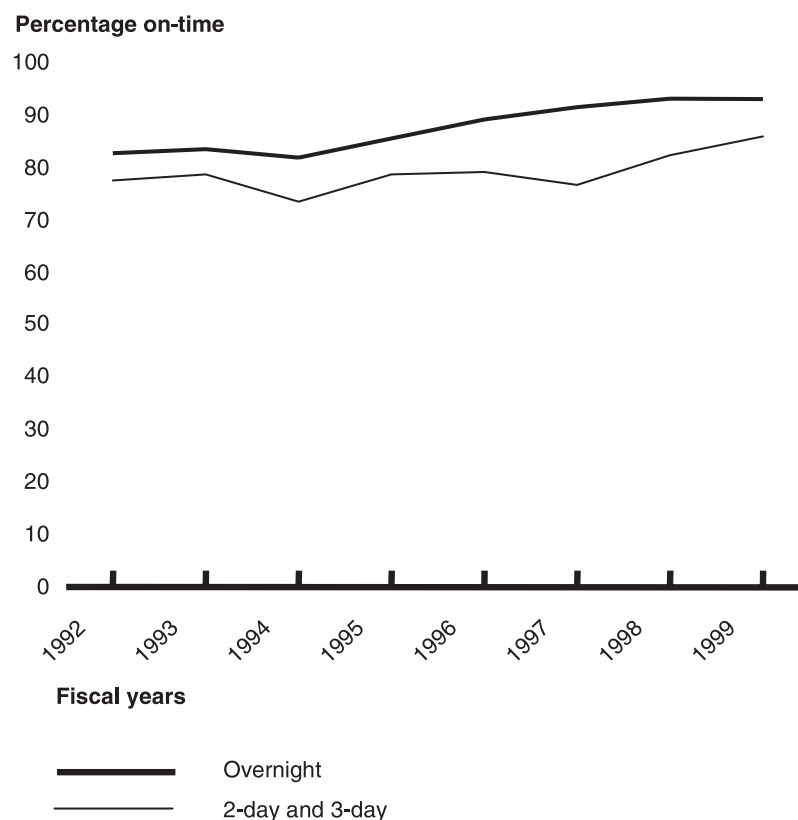
Source: U.S. Postal Service.

If the Service achieves these net income projections, it will be the first time that the Service has achieved positive net income for 6 consecutive years since postal reorganization was implemented in 1971. However, the Service's Integrated Financial Plan for fiscal year 2000 has reported that in order to accomplish net income of \$100 million in fiscal year 2000, the Service would need to realize a 1-percent reduction in workhours. This plan projected that growth in total mail volume will be 3.8 percent in fiscal year 2000, which would add to the Service's workload. Also, according to Postal Service data, the size of the Service's city and rural delivery network has increased more than 1 percent in each of the past 4 years. If the Service's delivery network continues to grow, this would further add to the workload of mail delivery. In addition, the Service has established goals to maintain or improve mail delivery service in fiscal year 2000.

The Postmaster General has stated that the Postal Service is cutting costs to preserve affordable rates but that service will not be sacrificed. As shown in figure 3, during the 1990s, the Service improved on-time delivery of First Class Mail that is to be delivered overnight, as well as First-Class Mail that is to be delivered 2 or 3 days after it is mailed. The Service also

appears to be on track for achieving record delivery service performance for this year. The Service's Performance Plan for fiscal year 2000 sets goals to continue the improved performance in these areas, as well as setting an additional performance target for on-time delivery of advertising mail.

Figure 3: On-Time Delivery
Performance for First-Class Mail



Source: U.S. Postal Service.

Challenges Facing the Service

We have identified four major challenges facing the Postal Service as the 21st century quickly approaches: (1) maximizing performance in the face of increasing customer demands and choices, (2) managing employees—the Service's most valuable asset—to maximize attainment of agency goals and continuous improvement of employee performance, (3) maintaining financial viability by controlling costs and enhancing revenues, and (4) adapting to a rapidly changing communications and delivery environment with a growing number of competitors.

Maximizing Performance

One of the major and continuing challenges that the Service faces involves its effort to maximize performance in the face of increasing customer

Statement**U.S. Postal Service: Challenges to Sustaining Performance Improvements Remain Formidable on the Brink of the 21st Century**

demands and choices. As part of this effort, the Service has established a results-oriented planning process. As required by the Government Performance and Results Act of 1993 (the Results Act), the Service has published annual performance plans. These plans were aligned with its planning process and identified the Service's major goals and objectives, strategies for accomplishing the goals and objectives, and some performance indicators to measure progress toward these goals.

The Service's performance plan should help guide its actions over the next year and provide information useful to the Service's ongoing dialogue with Congress and other stakeholders. The Preliminary Annual Performance Plan for Fiscal Year 2000 specified goals and targets for the Service's intended performance in such areas as providing timely delivery, improving workplace relations, and achieving its target for net income. In response to a report we issued in April 1999, the Service agreed to identify its top goals for fiscal year 2000 in its final performance plan.² Also, the final plan provided updated information on the Service's projected revenues and costs for fiscal year 2000 as well as an updated summary of the Service's efforts to reduce its costs.

Early next year, the Service is to publish its first annual program performance report under the Results Act as part of its Fiscal Year 2000 Comprehensive Statement on Postal Operations. This report should help the Service, Congress, and other stakeholders assess the Service's performance in the past fiscal year compared to the goals included in its performance plan. In this regard, it will be important to many postal stakeholders for the Service to continue to make tangible progress toward implementing a more complete set of performance measures and targets. For example, in fiscal year 2000, the Service intends to develop new measures of timely delivery of international mail, publications, and bill payments sent through the mail. As we observed in our January 1999 report on the Service's major performance and management challenges, the prospect of declines in the Service's core business has heightened the need for the Service to resolve long-standing performance issues and implement reliable indicators of postal performance.³

Ratemaking Data Quality

To date, limited assessments have been made of the reliability of the Service's performance data. Data integrity is vital to the Service's

²The Results Act: Observations on the Postal Service's Preliminary Performance Plan for Fiscal Year 2000 (GAO/GGD-99-72R, Apr. 30, 1999).

³Major Management Challenges and Program Risks: U.S. Postal Service (GAO/OCG-99-21, January 1999).

performance report as well as other mission-critical areas, such as setting postal rates. One study, which was initiated at the request of this Subcommittee, established a good beginning by assessing the quality of data used in postal ratemaking and identifying opportunities to improve the quality of these data.

The study involved a joint 1997 agreement among the Service, the Postal Rate Commission, and us to have an outside contractor conduct a comprehensive assessment of the quality of data used by the Service in setting postal rates. The study, conducted by A.T. Kearney, Inc., resulted in a report released earlier this year that included 47 recommendations designed to improve and enhance the completeness and the accuracy of data the Service provides for ratemaking.⁴ The contractor found that providing sufficiently complete and accurate data is an evolutionary process that requires the Service to continually improve the quality of its ratemaking and related data systems. For example, changes in operations require ongoing improvements to data systems to ensure that appropriate data are collected.

The contractor concluded that the quality of the data provided by the Service for ratemaking has generally been sufficiently complete and accurate to enable subclass rates to be based on reasonably reliable data. However, the contractor reported concerns that in some instances, the best available data were used regardless of their inherent levels of error or obsolescence. The contractor concluded that "...improvements and enhancements can--and must--be made to ensure future data provided for rate making will be sufficiently complete and accurate." Some of the key recommendations related to the following areas:

- Mail processing: better measure costs related to mail processing;
- Delivery: update and improve the quality of special study data used to determine delivery costs;
- Capital and support: improve the measure of capital and support costs; and
- Revenue, volume, and weight: improve the completeness and accuracy of mail revenue, volume, and weight data as well as develop more accurate analyses of the impact of weight on costs.

⁴Data Quality Study, April 16, 1999, prepared by LINX, a division of A.T. Kearney, Inc. This report is available at the U.S. Postal Service Internet site at <http://www.usps.gov/clr/dqs.htm>.

Statement

U.S. Postal Service: Challenges to Sustaining Performance Improvements Remain Formidable on the Brink of the 21st Century

We believe that the study has made an important contribution to analyzing the issues, making the case for change, and offering constructive recommendations for short-term and long-term improvements. Postal officials have indicated that they agree with most of the study's recommendations. They said that the Service is taking steps to implement some of the recommendations, such as updating some special studies used to help estimate postal costs. For a number of recommendations, they plan to conduct additional evaluation or analysis to assess what followup may be needed. Overall, it is not clear what specific actions the Service plans to take to improve the quality of data used in ratemaking and the timeframes for completion.

As you know, Mr. Chairman, you requested this study to address concerns raised by the Chairman of the Postal Rate Commission and others about the data deficiencies in the Postal Service's 1994 rate filing. Further, issues related to the quality of data used in ratemaking have been an important area of continuing oversight for this Subcommittee. Given the importance of data quality to setting postal rates, as well as the level of congressional concern in this area, we believe it is important for the Postal Service to demonstrate to Congress, the Postal Rate Commission, stakeholders, and the public that it is making progress in improving the quality of data used in ratemaking. Therefore, we are recommending that the Postmaster General report to the congressional oversight subcommittees on the actions taken and planned to improve the quality of data used in ratemaking.

Managing Employees

Management of its employees constitutes one of the Service's major challenges in meeting goals and maximizing performance. The Service employs nearly one-third of the federal civilian workforce and is the single largest federal civilian agency. To carry out its mission, the Service had a total of about 900,000 career and noncareer employees as of September 30, 1998.⁵ To operate effectively in a rapidly changing environment, the Service has recognized that it will need to give human capital issues a higher priority and enhance each employee's contributions to organizational performance. The Service's Year 2000 Performance Plan states that its revised Voice of the Employee goal "elevates the quality of the overall workplace environment from a subgoal category to a corporate

⁵According to the Service, career employees generally are persons who have permanent work appointments and include such employees as clerks, postmasters, managers, supervisors, mail handlers, and city and rural letter carriers. Noncareer employees are persons who have limited-term work appointments and include such employees as some data conversion operators who work at postal remote encoding centers and substitutes for rural carriers.

goal, and emphasizes that the end result should achieve organizational and individual success.”

Labor-Management Relations

We have previously reported on long-standing problems in labor-management relations that have affected the postal workplace environment. Although the Service has continued to make progress in improving its labor-management relations, problems still exist that appear to create barriers between the Service and its main employee organizations, including four major postal labor unions and three management associations. Such barriers have often stood in the way of agreements being reached among the eight organizations, including postal labor unions’ collective bargaining agreements, that could help ensure the most effective management of the Service’s employees. Also, disagreements have prevented the establishment of an overall framework agreement, which we recommended in our 1994 report on postal labor-management relations.⁶ Such an agreement could help the eight organizations focus on common approaches for addressing persistent labor-management relations problems so that the Service’s work environment can be improved and its competitive position in a dynamic communications market can be maintained.

The Service has identified a number of goals and strategies to improve its workplace relations and to enhance various employee programs, such as its diversity program. However, full success of these efforts is unlikely without a partnership between postal managers and employees. Without such a partnership, difficulties in the postal workplace are likely to persist and hamper the Service’s ability to best achieve its overall performance goals.

One area that has historically posed a challenge to the Service and its unions and management associations involves compensation and benefits issues. The most recent contract negotiations occurred during the last year for three of the four major postal labor unions whose contracts expired in November 1998.⁷ Negotiations for new contracts between the Service and two of the three unions—the American Postal Workers Union (APWU) and the National Postal Mail Handlers Union (Mail Handlers)—produced settlements without the use of arbitration. However, for one of

⁶U.S. Postal Service: Labor-Management Problems Persist on the Workroom Floor (GAO/GGD-94-201A/B, Sept. 29, 1994).

⁷The three major postal labor unions involved in 1998 contract negotiations with the Service included APWU, NALC, and Mail Handlers. The fourth union—the National Rural Letter Carriers’ Association—did not participate in such negotiations because its contract is not due to expire until November 1999.

Statement

U.S. Postal Service: Challenges to Sustaining Performance Improvements Remain Formidable on the Brink of the 21st Century

the three unions—the National Association of Letter Carriers (NALC)—interest arbitration involving a third-party negotiator was used to settle contract disputes regarding employee wages and benefits and to reach an agreement last month.

In recent months, concerns about compensation and benefits for postmasters have also been raised by members of two of the three management associations, including the National Association of Postmasters of the United States (NAPUS) and the National League of Postmasters of the United States (NLPM).⁸ Unlike the unions, management associations, which generally represent the interests of postal managers, supervisors, and postmasters, may not collectively bargain for contract employment terms. However, the Service is required by the Postal Reorganization Act of 1970 to consult with the management associations on various issues that affect their members, including compensation and benefits. We briefed the Subcommittee earlier this year on the concerns that had been raised by organizations representing postmasters related to compensation issues. In August 1999, these management associations reached agreement with the Service on compensation matters. However, these associations have continuing concerns related to the extent of the differential in pay between bargaining unit employees and supervisory and managerial employees.

During the past year, our work related to postal employees has focused mainly on issues involving diversity and equal employment opportunity (EEO) and employee safety and health. I would like to briefly discuss the results of our completed work and provide information about our continuing work efforts in these areas.

Diversity and Equal Employment Opportunity

One of the Service's many challenges involving employees relates to the areas of employee diversity and EEO. In large part, our completed work in these areas has generally addressed the Service's efforts to achieve specific diversity goals, such as the promotion of women and minorities into higher postal management levels, and the Service's tracking and monitoring of specific data related to EEO complaints.

Concerning the promotion of women and minorities to higher management levels, we issued two reports to Congressman Danny Davis, one in

⁸The three management associations include NAPUS, NLPM, and the National Association of Postal Supervisors.

September 1998,⁹ and one in February 1999.¹⁰ In the September 1998 report, we discussed the results of our work on the Service's compliance with promotion procedures at three postal locations.¹¹ Specifically, we obtained and analyzed various data to determine the extent to which women and minorities were represented at the higher Executive and Administrative Schedule (EAS) management levels. The results of our work showed that for 117 promotions that were awarded in 3 postal locations, many of the applicants (62 percent) and those determined best qualified (64 percent) were women and minorities. Also, of the employees promoted to higher level management positions in the three locations, about 62 percent were women and minorities, compared with the 59 percent at the same grade levels in these locations before the promotions took place.

In addition, our February 1999 report to Congressman Davis supplemented the September 1998 report by providing comprehensive data on the extent to which women and minorities were represented at higher postal management levels, including promotion-related data. The February 1999 report also included information on other issues, such as (1) the lack of reliable EEO data on promotion applicants' progress through the promotion process and (2) the Service's progress in responding to specific recommendations made in 1997 by Aguirre International—an outside firm that reviewed the Service's diversity program—that were intended to help the Service strengthen its program.

In the February 1999 report, we recommended that the Postmaster General ensure that appropriate Service officials capture and use EEO group data to help improve the Service's diversity program, including the identification of any barriers that might impede promotions to high-level EAS positions. In response to our recommendation, the Vice President for Human Resources told us that she would emphasize to postal field facilities the need to enter data into the appropriate data system so that more complete and reliable information about promotions could be maintained and used as a tool to identify the points that impede the promotions of applicants to high-level EAS positions.

⁹U.S. Postal Service: Information About Selected Promotions of Women and Minorities to EAS Management-Level Positions (GAO/GGD-98-200R, Sept. 21, 1998).

¹⁰U.S. Postal Service: Diversity in High-Level EAS Positions (GAO/GGD-99-26, Feb. 26, 1999).

¹¹The three locations where we reviewed applications for the 117 promotions included the Atlanta, Dallas, and Van Nuys performance clusters. A performance cluster is 1 of the Service's 85 geographic service areas and includes a customer service district, which is responsible for overseeing post offices, and 1 or more mail processing plants.

Also, the results of some of our completed work in the area of EEO complaints indicated that shortcomings existed in the collection and reporting of specific EEO-related data, such as the bases for complaints and issues involved in the complaints. Without reliable information, managers will not be able to determine how best to address problems regarding the nature and extent of conflict in the postal workplace or assess the extent to which improvements can be made.

In addition, as requested by Congressman Chaka Fattah, the Subcommittee's Ranking Minority Member, we are currently reviewing the Service's progress in achieving a diverse workforce in its Postal Career Executive Service (PCES), which represents the Service's senior level officers and executives. We are working to obtain information about diversity within PCES similar to the information that we provided in our February 1999 report about diversity within the Service's high-level EAS workforce.

Employee Safety and Health

Another significant challenge the Service faces is implementing the Postal Employees Safety Enhancement Act. Prior to the act, the Postal Service was required to comply with Occupational Safety and Health Administration (OSHA) safety and health program requirements for federal agencies. When OSHA found safety and health problems at postal facilities, it issued notices of unsafe or unhealthful working conditions, but it did not issue citations or levy monetary penalties. However, the act, which became effective on September 28, 1998, required the Postal Service to comply with OSHA requirements for private sector employers. Accordingly, OSHA may now impose citations and monetary penalties on the Postal Service for noncompliance.

In converting from requirements for federal agencies to provisions for private sector employers, postal officials stated that they would have to review and modify existing safety and health policies, programs, procedures, systems, training, and education programs, as well as modify recordkeeping procedures for accident and injury data. The officials said that challenges associated with implementing the requirements of the act include (1) modifying existing automated systems at the same time that government, industry, and the Service are dedicating their technical resources to ensure Year 2000 compliance; (2) developing and implementing training programs on the judicial and other processes that previously were not applicable to the Postal Service for safety personnel, legal staff, and key operations staff; and (3) modifying the Service's financial system to track expenses associated with implementing the new requirements.

Maintaining Financial Viability

The Postal Service's ability to maintain financial viability by controlling costs, improving productivity, and enhancing revenues also presents a continuing challenge. The Service's strategic plan stated that aggressive cost management would be necessary to guarantee success in mitigating historic cost trends that drive price increases. The Service's Annual Performance Plan for Fiscal Year 2000 established goals for controlling costs through cost reduction programs as well as by achieving productivity gains. The plan also reported that it is not unusual for the Service's productivity to fluctuate from one year to another, but over the long run a successful organization will achieve positive growth in productivity. Further, the Service has recognized that it must have strong and effective internal operating controls to avoid unwarranted costs and protect its revenues.

Controlling Costs

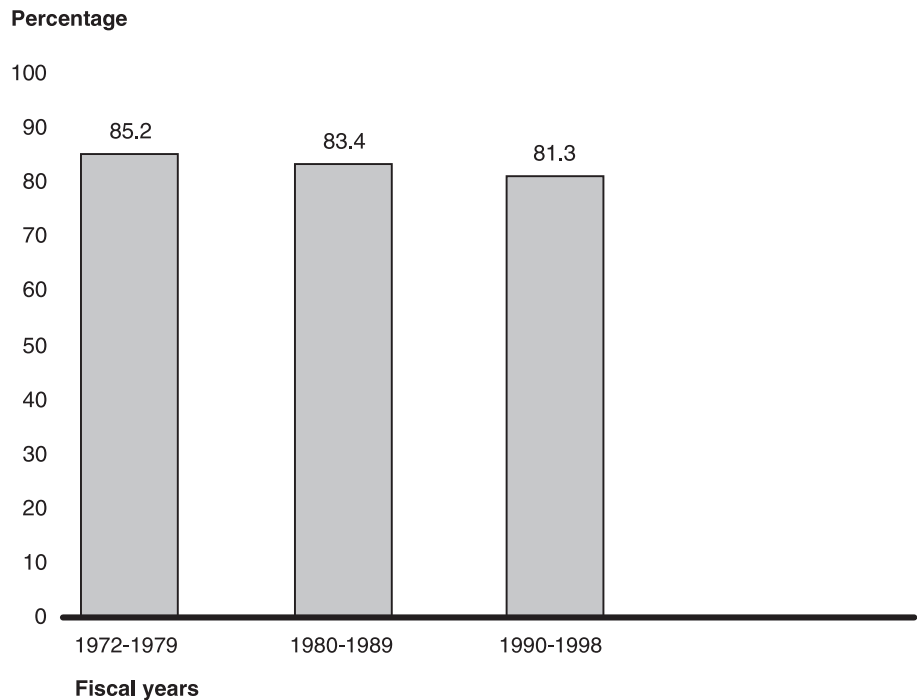
Effective management of the Service's capital investments is critical if the Service is to achieve its projected return on investments. The Service reported that it has made aggressive capital investments in technology and infrastructure to improve the distribution and delivery of mail as well as reduce labor costs.

In September 1998, the Postal Service Board of Governors confirmed the Service's plan to spend \$17 billion through fiscal year 2002 on capital investments that are intended to automate and modernize operations and control costs. The Service has reported in the past that it intends to substitute capital for labor to help it achieve its financial goals. As shown in figure 4, labor-related expenses accounted for more than 80 percent of the Service's total expenses in each of the past 3 decades. The Service's labor-related expenses declined somewhat during the 1990s but continued to represent 79 percent of the Service's expenses in fiscal year 1998, the most recent year for which data are available.

Statement

U.S. Postal Service: Challenges to Sustaining Performance Improvements Remain Formidable on the Brink of the 21st Century

Figure 4: Labor-Related Expenses Accounted for Most of the Postal Service's Total Expenses



Note: Labor-related expenses include such costs as employee compensation and benefits, retroactive assessments for employee benefits, imputed interest expenses on retroactive assessments for employee benefits, interest expenses on deferred retirement liabilities, and workers' compensation expenses of the former Post Office Department. Percentages shown were compiled by dividing the Postal Service's total labor-related expenses for each period by the Service's total expenses for that period. Data for fiscal year 1999 are not yet available.

Source: U.S. Postal Service annual reports.

The Service stated in its Five-Year Strategic Plan for fiscal years 1998 through 2002 that the cost paid for labor resources is the primary driver of Postal Service prices, and that significant revenue growth must be matched by aggressive cost management for the Service to mitigate historic cost trends that drive price increases. Further, the Service has recognized that its stakeholders are also demanding aggressive cost management.

As mentioned earlier, although the Service has improved its delivery performance in some areas, questions remain about whether the Service is adequately realizing the anticipated savings from its capital investments. Last year, the Board of Governors approved a capital investment budget of \$4.4 billion for fiscal year 1999, of which the largest component—\$1.7 billion—was committed to facility projects, and \$1.5 billion was committed to equipment projects. Last year, we reported to the Subcommittee on the

Statement

U.S. Postal Service: Challenges to Sustaining Performance Improvements Remain Formidable on the Brink of the 21st Century

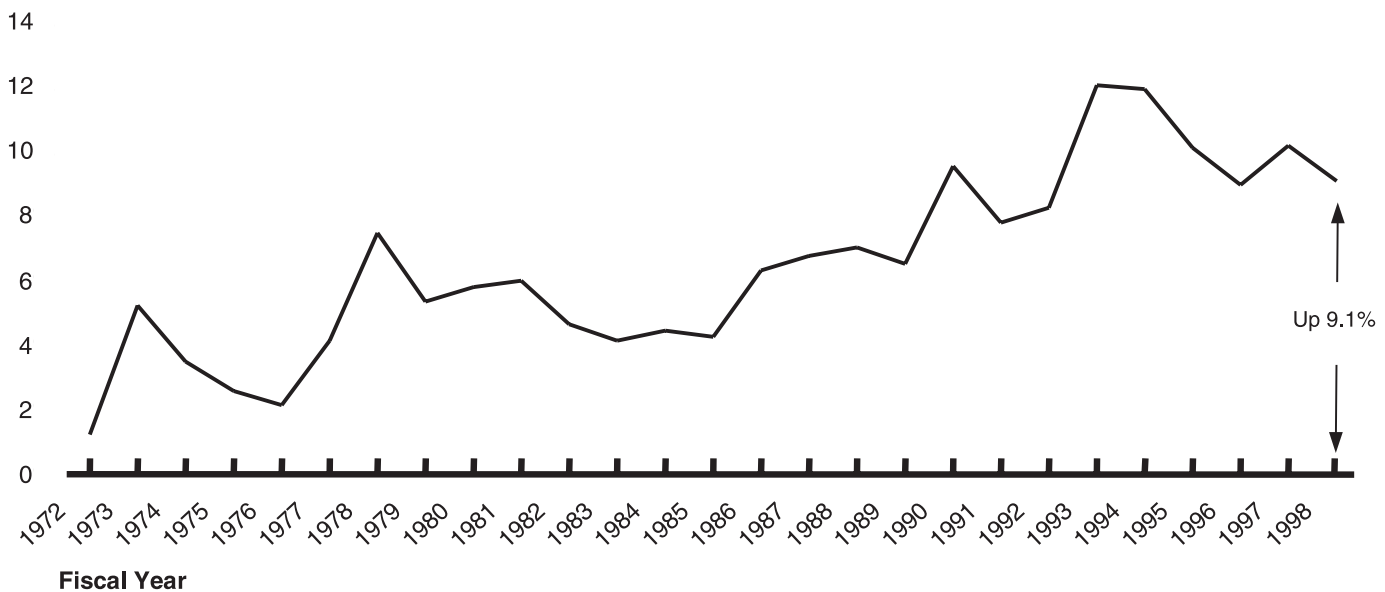
Service's shortfalls in reaching its projected carrier workhour savings from its investments in automated sorting equipment.¹²

Improving Productivity

The Service has reported that its Integrated Financial plan for Fiscal Year 2000 relies on "aggressive productivity improvement" in order for the Service to meet its "challenging bottom-line target" of \$100 million in net income. The Service's performance plan for fiscal year 2000 set a target of increasing total factor productivity (TFP) by 3.1 percent.¹³ To put this challenge into context, figure 5 indicates that TFP increased at least 3 percent in only 4 years since postal reorganization was implemented (1973, 1978, 1990, and 1993).

Figure 5: Growth in Postal Service Productivity

Cumulative percentage change



Note: Data for fiscal year 1999 are not yet available.

Source: U.S. Postal Service.

¹²U.S. Postal Service: Progress Made in Implementing Automated Letter Sequencing, but Some Issues Remain (GAO/GGD-98-73, Apr. 17, 1998).

¹³TFP measures the changes in the relationship between the Service's outputs and resources expended in producing those outputs. The Service's main outputs are mail volumes and servicing an expanding delivery network. By tracking outputs and resource usage, TFP provides a measure of historical performance.

In addition, TFP declined in 4 of the last 5 years for a cumulative decline of about 3 percent. The Service reported that the TFP decline in 1998, the most recent year for which data are available, was linked to an increase in its capital investments and the conversion of many transitional employees to career status. The Service reported that it expects to realize deferred benefits from automation that should help increase its productivity in the future.

The Service has reported that its aggressive capital investments, though consistent with its long-term strategy of substituting capital for labor, may have a short-term negative impact on TFP due to implementation costs and the difference between the timing of costs and the realization of savings. The Service's plan for \$4.0 billion in capital commitments¹⁴ in fiscal year 2000—compared with \$3.9 billion in capital commitments in fiscal year 1998 when TFP declined by 1.1 percent—points to the challenge of increasing TFP by the target of 3.1 percent in fiscal year 2000. Moreover, the Service has reported that some investments improve service but do not improve TFP.

The Service has cautioned that TFP is best used to analyze long-term trends and is not effective as a short-term measure or snapshot in time. In this regard, as figure 5 shows, TFP increased 9.1 percent from the time that postal reorganization was implemented to fiscal year 1998. The Service has recently reported that its objective is to improve TFP over time while maintaining a balance with the service improvements necessary to achieve customer satisfaction and maintain a competitive position in the marketplace.

Enhancing Revenues

Another key area of the Service's financial goals is to enhance revenues. In the past, we have raised concerns about the adequacy of the Service's controls over its revenues in areas such as the acceptance of bulk business mail.¹⁵ In fiscal year 1998, bulk business mail represented 49 percent of the Service's \$58 billion in mail revenues and about 66 percent of the nearly 200 billion pieces of mail it processed. We are currently conducting a follow-up review to determine the status of the Service's actions to implement our recommendations. We expect this report to be issued within the next several weeks.

¹⁴The Service's capital commitments in its Capital Investment Plan represent expected contract awards or options. The Service generally does not pay for these expenses until the goods are delivered or a contractor meets its project schedule.

¹⁵U.S. Postal Service: Stronger Mail Acceptance Controls Could Help Prevent Revenue Losses (GAO/GGD-96-126, June 25, 1996).

Statement

U.S. Postal Service: Challenges to Sustaining Performance Improvements Remain Formidable on the Brink of the 21st Century

The Service has also enhanced its revenues through leasing or selling some of its real estate. We recently issued a report that looked at two real estate projects where the Service leased space to private companies that developed and operated the buildings—the Grand Central Station Post Office in New York City and Rincon Center in San Francisco.¹⁶ The Service reported obtaining about \$16.5 million annually in revenue from renting space in the renovated buildings while preserving their historical characteristics. In addition, the Service recently sold the Rincon Center for \$80.5 million, which the Service reported added to its net revenues.

Competing in a Rapidly Changing Environment

The Service's ability to adapt to increasing competition is critical if the Service is to maintain a competitive position in the rapidly changing communications and delivery environment. Increasing competition, particularly from electronic alternatives, has slowed the Service's revenue growth and is expected to have a continuing impact on the Service's revenues in the next decade.

Other issues related to the Service's competitive position have also been raised. Some concerns revolve around types of new products and services that the Service is allowed to develop. We recently provided information on the Postal Service Marketing Department's process for the review and approval of its new products. Also, some of our work has addressed various concerns regarding the Service's competitive position with respect to international postal organizations.

New Postal Products

The Service has for several years been concerned that its First-Class Mail business could become threatened as more and more traditional mail migrates to electronic mail. Coupled with this, the Service has encountered competition from the private sector that is significantly more challenging than in past years. To address these situations, postal management, in the early 1990s, established a corporate goal of initiating and growing new businesses, particularly in the electronic communications arena, in order to ensure its commercial viability as a mover of messages, merchandise, and money.

As a result of this corporate decision, in the mid-1990s, the Service began focusing resources on the aggressive development and introduction of new products—primarily nonpostal products. In November 1998, we reported on the challenges faced by the Service in moving in this new direction and

¹⁶Public-Private Partnerships: Key Elements of Federal Building and Facility Partnerships (GAO/GGD-99-23, Feb. 3, 1999).

presented a snapshot of the progress made to date.¹⁷ We reported that the Service's new products initiative was controversial. Some Members of Congress were concerned that the Service was unfairly expanding its product line to compete in nonpostal-related markets and had introduced legislation to curtail such activity. Some private sector companies also complained about the Service's entry into nontraditional postal markets. They were concerned that the Service could use its governmental status to an unfair advantage when introducing products that compete with private sector companies. Notwithstanding this controversy, the Service moved ahead with several new products in the mid- to late-1990s.

The Service has established a formalized process to govern the introduction of most new products. To facilitate the process of developing and introducing new products and to ensure effective management control, the Service developed a formalized system of checks and balances that requires top management buy-in at critical stages of the product development process. The process is also to be used to review the performance of products and terminate those that do not perform to Postal Service expectations. For those products we reviewed in more detail, we found that the Service had generally followed the tenets of the newly established product development process. We also reported that most of the new products had not yet produced revenues that exceeded expenses. We cautioned, however, that it might not be reasonable to expect all new products to become profitable in their early years, because new products generally take several years to become established and recover their start-up costs.

International Competition

Congress has recently considered one of the major international competition-related concerns involving a potential conflict in the Service's dual role as the U.S. negotiator of international postal agreements and competitor with private carriers in the international mail arena. In a recent report, we compared the roles of the Service and the Department of State as representatives of the U.S. government in international organizations for the postal and telecommunications sectors.¹⁸ The Department of State has the lead responsibility for developing U.S. international telecommunications policy and heads a formalized process for policy development. In October 1998, Congress transferred responsibility for formulating, coordinating, and overseeing international postal policy at the international postal organization, the Universal Postal Union (UPU), from

¹⁷U.S. Postal Service: Development and Inventory of New Products (GAO/GGD-99-15, Nov. 24, 1998).

¹⁸U.S. Postal Service: Postal and Telecommunications Sector Representation in International Organizations (GAO/GGD-99-6BR, Oct. 29, 1998).

the Service to the Department of State. We are currently reviewing how effectively the Department of State has implemented its new responsibilities in this area.

Our October 1998 report noted that differences in legal requirements contributed to differences in stakeholder involvement and the processes used to develop U.S. policies for international postal and telecommunications issues. One key difference was that the Department of State was legally required to obtain input from the private sector on international telecommunications policy issues; however, the Service was not subject to such legal requirements when it had the lead role for U.S. involvement in the UPU. In the international telecommunications sector, we found that government and private sector stakeholders had more direct involvement in U.S. policy formulation through a structured and documented advisory committee process headed by the Department of State and subject to the requirements of the Federal Advisory Committee Act (FACA).¹⁹ FACA requirements include Federal Register notice of advisory committee meetings; detailed minutes of meetings; public access and participation at meetings; and annual reports to the General Services Administration, which is to report to Congress on the activities, status, and any changes in the advisory committees. In the postal sector, the Service was not subject to FACA. The process for involving government and private sector stakeholders in international policy formulation was more informal, involving ad hoc briefings with limited public notice or documentation of meetings. Our ongoing review will examine how the process for U.S. policy formulation, coordination, and oversight has changed this year with respect to U.S. participation in the UPU.

Other Major Issues

Other major issues we recently addressed include monitoring the Service's actions to meet the challenges of preparing for the Year 2000 as well as protecting consumers from deceptive mail practices, protecting the privacy of address changes, and improving its management of capital facility projects. Currently, we are also reviewing the effectiveness of the Breast Cancer Stamp as a fundraiser.

Regarding Year 2000 readiness, we testified that the Service started late in correcting and testing its systems, preparing a master schedule, and developing contingency and business continuity plans. However, the Service has made significant progress in reducing vulnerabilities identified

¹⁹FACA was enacted to ensure that (1) valid needs exist for establishing and continuing advisory committees, (2) the committees are properly managed and their proceedings are as open as possible to the public, and (3) Congress is kept informed of the committees' activities.

in previous assessments and in planning a recovery management process to restore its operations if Year 2000 problems should occur.

We also testified recently before this Subcommittee on our work related to protecting consumers from deceptive mail marketing practices.²⁰ We provided information on the extent and nature of consumers' problems with deceptive mail and identified initiatives various federal agencies and other organizations have made to address deceptive mail problems and educate consumers.

We also recently released a report on another issue of interest to consumers, the Service's protection of consumer address information from unauthorized disclosure.²¹ We followed up on the recommendations we had previously made for specific actions the Service should take to strengthen oversight of its National Change of Address (NCOA) program. The Service had not taken action on our recommendation that it explicitly state, in the acknowledgment form signed by customers of the Service's address correction licensees, that NCOA program-linked data are not to be used to create or maintain new-movers lists. We have suggested that Congress may wish to consider amending the Postal Reorganization Act of 1970 to establish requirements concerning the language in the form so that the Service could help ensure that the use of NCOA program-linked data is limited to the purposes for which they were collected.

Year 2000 Problems

The Postal Service faces a major challenge in updating its computer systems, mail processing equipment, and infrastructure equipment to avoid Year 2000 malfunctions that could disrupt mail delivery. The Service has a special responsibility to correct its computers because a number of private sector and government groups may need to use the Service as a backup delivery system if their computers malfunction. For this reason, the Service is concerned about the prospect of a mail surge in January 2000. An early assessment by the Service's Office of Inspector General showed that the Service was slow to recognize the scope of the challenge and act to ensure that its computer systems were Year 2000 compliant.

In February 1999²² we identified the major challenges facing the Service, including (1) completing system renovation and mail processing

²⁰Deceptive Mail: Consumers' Problems Appear Substantial (GAO/T-GGD-99-150, Aug. 4, 1999).

²¹U.S. Postal Service: Status of Efforts to Protect Privacy of Address Changes (GAO/GGD-99-102, Jul. 30, 1999).

²²Year 2000 Computing Crisis: Challenges Still Facing the U.S. Postal Service (GAO/T-AIMD-99-86, February 23, 1999).

equipment correction and testing, (2) ensuring the readiness of hundreds of local facilities, (3) determining the ability of key suppliers and electronic data exchange partners to be Year 2000 ready, (4) completing simulation testing of business process areas, and (5) completing the development and testing of business continuity and contingency plans.

Since February, the Service has strengthened its management approach to the Year 2000 problem and made significant progress in fixing its systems and determining that its key suppliers and electronic data exchange partners will also be Year 2000 ready. For example, as of this August, the Service reported to the Office of Management and Budget that it

- completed renovation of 136 of its 137 severe and critical computer systems and expected to complete all non-mission critical systems by September 30, 1999;
- certified all 38 critical mail processing equipment and embedded chip devices as Year 2000 ready;
- performed business impact assessments on all 353 critical field facilities and expected to finish remaining readiness activities by October 15, 1999;
- expected to complete impact assessments by November 30, 1999, for all 3,500 field activities that have automated systems and functions with life safety and security ramifications;
- obtained assurances of Year 2000 readiness for 273, or 99.6 percent, of its critical suppliers and completed site visits for all 34 “high profile” suppliers, i.e., those most integral to the continuity of mail operations;
- obtained assurances on Year 2000 readiness for 73 percent of suppliers critical to the Service’s field operations; and
- certified all 737 severe and critical electronic data exchanges as Year 2000 compliant and reported that all 106 important, but not critical, electronic data exchanges would be certified as compliant by September 30, 1999.

The Service has also stepped up efforts to test applications and infrastructure equipment in a production environment—an important phase of the Year 2000 effort because Year 2000 conversions often involve numerous large interconnecting systems with many external interfaces

and extensive supporting technology infrastructures. Over 40 applications that support critical business processes were tested in the first of a two-phased testing effort that ended in August 1999. The Service is still analyzing the results of these tests; however, it has reported that at least one application will require additional testing.

Finally, the Service has completed over 500 business continuity and component contingency plans for its critical processes. This is another crucial phase of the Year 2000 effort because core processes may still be disrupted by Year 2000-induced failures and by errors in business partner systems or public infrastructure systems, such as power, water, transportation, and telecommunications systems. The Service's plans include preemptive measures and work-arounds to ensure critical business processes continue in the event of a Year 2000-related disruption or system failure. The field plans were distributed in August 1999, and all rehearsals and adjustments to these plans are expected to be completed by November 30, 1999.

With these actions under way, the Service is clearly much better positioned to face the upcoming century change. However, the challenge facing the Service is still significant: there are less than 3 months remaining before the Year 2000 deadline, the Service is now entering into the holiday business rush, and many important tasks—including the rehearsal and finalization of contingency and continuity plans—remain. Thus, the Service will need to sustain top management attention to the problem and continue to do everything necessary to ensure that the continuity of important postal operations is maintained into 2000.

Status of Antelope Valley Project Remains Uncertain

The importance of sustained management attention was evident in another area where we identified weaknesses in the management of a capital facility project. In August 1999, we reported on the Service's project approval process for a proposed project to relocate postal operations to a new mail processing facility in the Antelope Valley area in California.²³ We raised concerns about the unresolved status of the proposed project after almost 10 years. The Service purchased a 25-acre site in Lancaster, CA, for \$6.5 million in 1991 that has since remained unused due to the Service's failure to decide on whether the proposed processing facility should be approved. Also, we estimated that accumulated interest costs associated with this \$6.5 million investment totaled about \$2.9 million from the time the site was purchased in October 1991 through June 1999, and they were

²³U.S. Postal Service: Deficiencies Continue While Antelope Valley Project Status Remains Uncertain (GAO/GGD-99-147, Aug. 31, 1999).

Statement**U.S. Postal Service: Challenges to Sustaining Performance Improvements Remain Formidable on the Brink of the 21st Century**

likely to increase by over \$300,000 each year. In addition, the Service has not addressed the long-standing problems, such as mail delivery problems and space deficiencies, that were the basis for the proposed Antelope Valley project. We recommended that the Postmaster General take action to resolve the status of the project and report on planned actions to address the operational deficiencies in the Antelope Valley area.

Breast Cancer Research Stamp

One of our ongoing efforts is a review of the Service's Breast Cancer Research Stamp. The "Stamp Out Breast Cancer Act," enacted August 13, 1997, required that the Service market, for 2 years, a semipostal stamp for breast cancer research. A semipostal stamp is a stamp that carries a surcharge for a special purpose.

The Service issued the First-Class Breast Cancer Research stamp on July 29, 1998. The stamp is currently priced at 40 cents—33 cents for postage with a 7-cent surcharge. The stamp is to be available for sale until July 29, 2000. The net proceeds from the surcharge are going to the National Institutes of Health and Department of Defense for breast cancer research. The Breast Cancer Research Stamp is the Service's first-ever semipostal stamp.

In addition to requiring the Service to market the Breast Cancer Research Stamp, the act also mandated that the Comptroller General report to Congress, between January 29, 2000, and April 29, 2000, on the effectiveness and appropriateness of using a semipostal stamp to raise funds for breast cancer research. Also, this report is to include information on the monetary and other resources required of the Service to produce and market the Breast Cancer Research Stamp.

After 1 year of sales, the Service reports that surcharge revenue generated by the Breast Cancer Research Stamp totaled approximately \$8 million. We expect to issue our report on the stamp to Congress in the early part of the year 2000, as mandated by the act.

Recommendation

We recommend that the Postmaster General report to the House and Senate oversight subcommittees on the Postal Service on the actions taken and planned to improve the quality of data used in ratemaking, including

- actions taken to improve ratemaking data quality, such as those that relate to the recommendations included in the Data Quality Study conducted by A.T. Kearney; and

Statement

U.S. Postal Service: Challenges to Sustaining Performance Improvements Remain Formidable on the Brink of the 21st Century

-
- actions planned to improve ratemaking data quality, including the priorities and time frames for short-term and long-term actions.
-

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

Contact and Acknowledgment

For future contacts regarding this testimony, please contact Bernard L. Ungar at (202)-512-8387. Individuals making key contributions to this testimony included Teresa Anderson, Gerald Barnes, Anne Hilleary, Kenneth John, Sherrill Johnson, Roger Lively, Charles Wicker, and Lisa Wright-Solomon. Kim Raheb provided graphics support. Carl Urie and Greg Donnellon provided information on the Postal Service's Year 2000 compliance.

GAO Postal-Related Products Issued Since June 1, 1998

Performance Issues

The Results Act: Observations on the Postal Service's Preliminary Performance Plan for Fiscal Year 2000 (GAO/GGD-99-72R, April 30, 1999).

Major Management Challenges and Program Risks: U.S. Postal Service (GAO/OCG-99-21, Jan. 1999).

The Results Act: Observations on the Postal Service's Preliminary Annual Performance Plan (GAO/GGD-98-144, July 10, 1998).

Employee Issues

Equal Employment Opportunity: The Postal Service Needs to Better Ensure the Quality of EEO Complaint Data (GAO/GGD-99-167, Sept. 28, 1999).

Equal Employment Opportunity: Complaint Caseloads Rising, With Effects of New Regulations on Future Trends Unclear (GAO/GGD-99-128, Aug. 16, 1999).

Equal Employment Opportunity: Data Shortcomings Hinder Assessment of Conflicts in the Federal Workplace (GAO/GGD-99-75, May 4, 1999).

U.S. Postal Service: Diversity in High-Level EAS Positions (GAO/GGD-99-26, Feb. 26, 1999).

U.S. Postal Service: Information About Selected Promotions of Women and Minorities to EAS Management-Level Positions (GAO/GGD-98-200R, Sept. 21, 1998).

Equal Employment Opportunity: Rising Trends in EEO Complaint Caseloads in the Federal Sector (GAO/GGD-98-157BR, July 24, 1998).

Financial Viability Issues

Public-Private Partnerships: Key Elements of Federal Building and Facility Partnerships (GAO/GGD-99-23, Feb. 3, 1999).

Competition Issues

U.S. Postal Service: Development and Inventory of New Products (GAO/GGD-99-15, Nov. 24, 1998).

U.S. Postal Service: Postal and Telecommunications Sector Representation in International Organizations (GAO/GGD-99-6BR, Oct. 29, 1998).

U.S. Postal Service: Competitive Concerns About Global Package Link Service (GAO/GGD-98-104, June 5, 1998).

Other Major Oversight Issues

U.S. Postal Service: Deficiencies Continue While Antelope Valley Project Status Remains Uncertain (GAO/GGD-99-147, Aug. 31, 1999).

Deceptive Mail: Consumers' Problems Appear Substantial (GAO/T-GGD-99-150, Aug. 4, 1999).

U.S. Postal Service: Status of Efforts to Protect Privacy of Address Changes (GAO/GGD-99-102, July 30, 1999).

Year 2000 Computing Crisis: Challenges Still Facing the U.S. Postal Service (GAO/T-AIMD-99-86, Feb. 23, 1999).

Proposed Legislation: Issues Related to Honesty in Sweepstakes Act of 1998 (S. 2141) (GAO/T-GGD-98-198, September 1, 1998).

Ordering Information

The first copy of each GAO report and testimony is free. Additional copies are \$2 each. Orders should be sent to the following address, accompanied by a check or money order made out to the Superintendent of Documents, when necessary. VISA and MasterCard credit cards are accepted, also. Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

Order by mail:

**U.S. General Accounting Office
P.O. Box 37050
Washington, DC 20013**

or visit:

**Room 1100
700 4th St. NW (corner of 4th and G Sts. NW)
U.S. General Accounting Office
Washington, DC**

Orders may also be placed by calling (202) 512-6000 or by using fax number (202) 512-6061, or TDD (202) 512-2537.

Each day, GAO issues a list of newly available reports and testimony. To receive facsimile copies of the daily list or any list from the past 30 days, please call (202) 512-6000 using a touch-tone phone. A recorded menu will provide information on how to obtain these lists.

For information on how to access GAO reports on the INTERNET, send e-mail message with "info" in the body to:

info@www.gao.gov

or visit GAO's World Wide Web Home Page at:

<http://www.gao.gov>

**United States
General Accounting Office
Washington, D.C. 20548-0001**

Bulk Rate Postage & Fees Paid GAO Permit No. G100

**Official Business
Penalty for Private Use \$300**

Address Correction Requested
