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On behalf of the Postal Regulatory Commission

Before the U.S. House of Representatives Committee on Oversight
And Government Reform Subcommittee on Federal Workforce,
Postal Service and the District of Columbia
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Chairman Lynch, Ranking Member Chaffetz, and members of the Subcommittee, thank you for the opportunity to testify. I am pleased to represent the Commission at this hearing on Postal Service cost cutting efforts and their impact on postal operations and networks.

The Postal Regulatory Commission serves as the Postal Service's regulator with responsibility for providing transparency on its financial operations, pricing policies, and service performance to Congress, stakeholders and the general public and ensuring compliance with the Postal Accountability and Enhancement Act (PAEA). In this regard the Commission is acutely aware that the Postal Service is in a precarious financial position and needs to implement systemic changes with potential risks to its performance, service and long-term viability.

As the Commission reported in its Annual Compliance Determination (ACD) issued this past March, mail volume declined 4.5 percent, or 9.5 billion pieces, in Fiscal Year (FY) 2008. The Postal Service ended the year with a $2.8 billion loss, after essentially breaking even in the first half of the year. Without the required $5.6 billion payment to the Retiree Health Benefits Trust Fund mandated by the PAEA, the Postal Service would have had a $2.8 billion profit.

The Postal Service's mid-year numbers for FY 2009 show accelerated deterioration in both finances and volume. Through Quarter 2, which ended on March 30, the Postal Service had a net loss of $2.3 billion and a year-over-year decrease in mail volume of nearly 13 billion pieces. The rate of mail decline has also increased significantly, reaching 14.7 percent in Quarter 2, compared to 9.3 percent in Quarter 1 and a 4.5 percent drop last year.

The Postal Service is trying to find new revenue streams to offset its volume losses and it has begun using its flexibility under the law to pursue new growth strategies. The Commission so far has approved 49 negotiated service agreements (NSAs), which are designed to incent major customers to mail in larger volumes. Also in the past month, the Commission has received postal proposals for two innovative new growth efforts. One is the first market test under the PAEA, a two-year test of a less-than-truckload service called collaborative logistics, which would allow the Postal Service to earn new revenue hauling goods on pallets in space available on trucks that are currently underutilized. The Commission approved this market test on May 7. The second new marketing idea is popularly known as a "summer sale." This temporary price adjustment attempts to provide incremental revenue through a discount scheme that would reward mailers who increase their volumes above historical norms and expectations.

The Commission continues to encourage the Postal Service to use its new pricing flexibilities to develop new products, increase revenue and grow mail volume. The volume based NSAs have produced several million dollars in additional revenue since being approved. However, the two new marketing initiatives are in the early developmental stage. Consequently, the Postal Service must rely on cost-cutting and efficiency measures to deal with its current financial difficulties.

Based on financial results so far this year, the Postal Service will run out of cash unless it receives $2 billion in relief from legislatively mandated payments for retiree health benefit costs or there is a complete reversal in volume trends. Even with this relief, solvency is contingent on the Postal Service achieving nearly $6 billion in cost savings and utilizing its maximum $3 billion borrowing authority. These estimates also reflect the revenue gained from the price increases for competitive products implemented in January and the 3.8 percent increase for market-dominant products that took effect on May 11. Without legislative relief, the Postal Service is likely to have a year-end cash shortfall of $1.5 billion. In this event, the Postal Service would not be able to pay all of its obligations.

The gravity of the Postal Service's financial position reinforces the need for the Postal Service to provide thorough, regular and transparent updates on its finances and operational performance. In response to earlier Commission concerns, the Postal Service has begun to provide monthly financial reports. In addition to an income statement, the Postal Service also presents volume information by class, a breakdown of expenses by category, and a report on total work hours used.

The Postal Service is under considerable pressure to achieve its target to trim $5.9 billion in costs, primarily through network adjustments to increase efficiency and match its workforce to a diminishing workload. Through the first half of FY 2009 the Postal Service has achieved about 40 percent of its planned cost reductions. Savings in mail processing and transportation account for about a quarter of the achieved savings. Delivery and customer service account for about half of the achieved savings. The Commission will continue to monitor the Postal Service's progress toward the achievement of the planned cost savings through the rest of the year.

To provide universal mail service to the American people, the Postal Service operates a system of interlinking networks for receiving, processing, transporting and delivering mail, and for conducting related financial and operational transactions. The Postal Service has made significant changes within these networks and must continue to do so if it is going to increase efficiency and capture savings while adopting new technologies and adjusting to sizeable and volatile changes in demand.

For example, the Postal Service has announced that it will review and adjust 150,000 delivery routes by the end of calendar 2009. It is revising its national transportation network to use more ground transportation and less airlift. It is adjusting post office retail hours and reducing the number of neighborhood collection boxes. And, it is making numerous changes throughout its mail processing network of some 400 plants, which constitute the core of the national hub and spoke system that sorts and dispatches mail for delivery locally and across the nation.

The Postal Service submitted its reorganization plan for the processing network to Congress last June. I provided this Subcommittee with the Commission's views on that plan at a subsequent July 24 hearing. The Commission found that the plan lacked specific performance targets and goals. The plan also relied on a piecemeal approach that lacked a comprehensive vision for what the network would look like when reorganization was completed. This is still true. Nevertheless, the Postal Service is taking action and has made progress in reducing workhours and costs.

Within the processing network, the Postal Service is eliminating airport mail facilities, developing a strategy for its 21 Bulk Mail Centers, now reclassified as Network Distribution Centers, and it is adjusting work schedules and reviewing coverage areas for its Processing and Distribution Centers, which comprise the lion's share of the mail processing network. In general, the shape of the processing network appears largely unchanged, and the majority of savings are being derived through adjustments to staffing and processes.

The mail processing network is not only the heart of the mail system; it is at the center of technological change in the mail. The Postal Service is in the early stages of deploying a Flats Sequencing System (FSS) that will enhance the automation of flat sorting. The Postal Service expects the FSS system to significantly lower costs and improve service for flats, just as letter automation did for letters. Yet it took nearly a decade for those efficiencies to be fully realized.

The Postal Service reports that FSS systems installed in Dulles, Virginia have successfully completed testing and validation. Although the test and validation process had its setbacks, a multi-year nationwide deployment began this month, with the first FSS machines slated for installation in Columbus, Kansas City, and Phoenix. In phase 1 of its plan, the Postal Service anticipates deploying 100 machines. These are very large and expensive pieces of equipment, which require considerable plant space to operate efficiently. It is essential that the Postal Service coordinate its various plant changes to ensure they work harmoniously and deliver the maximum return on time and investment. Postal work hours have declined significantly over the past year as the Postal Service has moved to match resources with the declining workload. In areas where costs are highly correlated with mail volume, the Postal Service has achieved a higher percentage of work hour reductions. For example, mail processing and customer service work hours have decreased by 13.9 and 12 percent, respectively. In the delivery network, which has a higher percentage of fixed costs, work hour reductions have been harder to obtain. Work hour usage for city carriers has declined 6.2 percent and rural delivery work hours have declined 4.8 percent.

Personnel reductions entail risk to service quality. The Postal Service has strongly asserted its intention to ensure that service quality is not diminished While the Commission does not doubt the sincerity of those intentions, it is critical that service be accurately measured and reported to ensure that the outcome is achieved.

As the Commission reported in its Annual Compliance Determination, just 20 percent of mail volume was objectively measured for service performance in 2008. However, the results for this mail were good. The speed of delivery improved for the mail that was measured. During this same period, the Postal Service was able to reduce 50 million work hours from the prior year, indicating that service improvement and cost cutting are not inherently incompatible.

The external measurement system that confirmed these results has been in existence for nearly two decades. When the system debuted in 1990, the Postal Service was reporting a 95-percent on-time performance for First-Class Mail based on its own internal measurements. External measurement provided a far different picture, with on-time results in the low 80s.

It was clear that the new measurements provided a more accurate view of the service that was actually being delivered to customers. The Postal Service, to its credit, publicly reported the results and resolved to improve the service, which it has done. Last year, 96 percent of local First-Class Mail was delivered overnight.

As this experience shows, accountability for objectively measured service performance helps drive service improvement. Building on this idea, the PAEA directed the development of service standards and measurement systems for the Postal Service's market-dominant products, which account for about 95 percent of mail volume.

The Postal Service, in consultation with the Commission, established the standards last year and they are publicly available through the respective websites. For the standards to be meaningful, however, a robust measurement system is required. This is now in development. In November, the Commission approved the concept for a measurement system based on the Intelligent Mail Barcode (IMb). This system will augment the existing external measurement procedure and provide performance data for the majority of mail volume that is not currently covered.

The IMb approach relies on Postal Service technology to capture data as mail passes from the mailer through the system to ultimate delivery. By piggy-backing on existing technology, the Postal Service's goal is to keep down the cost of the measurement system. The Commission has identified two important risks. First, the Postal Service must prove its ability to implement and maintain the system, which is a work in progress. Second, mailers need to invest in migrating substantial mail volumes to the IMb platform so that statistically valid data can be gathered. The system, which has been in test mode for some time, went live this month. The Commission will continue to monitor its development and consult with the Postal Service on performance and improvements. For example, in addition to publishing service-wide results, the Commission is recommending that the Postal Service report performance data at the Area and District level to better target service improvement efforts.

These measurement systems are critical tools for postal managers and customers to ensure that service is delivered as expected. Also, comprehensive measurement will help ensure that price cap restrictions are not circumvented by diminishing the quality of service provided. The Commission will continue to work with the Postal Service and to exercise its regulatory authority to improve system performance overtime and to ensure prompt, accurate and transparent performance reports.

The complement to speed of delivery is customer service. While the Postal Service has arguably reduced customer service by shortening retail hours, eliminating vending machines and reducing the number of collection boxes, it has also expanded customer access and convenience through technology and third-party providers. For example, customers can purchase stamps by mail, phone and Internet, as well as through thousands of private-sector stores that sell stamps at face value on consignment. Postal customers can also access many postal services online at USPS.com, including change-of-address, mail forwarding, hold-mail services, and carrier pick-up for packages.

The Commission has a number of critical roles in safeguarding service. By statute, the Postal Service is required to seek the Commission's advice before implementing nationwide service changes. The Commission then provides a forum for public input on the changes and incorporates the public's views in its Advisory Opinion. The Commission also reviews public appeals of post office closings, and it has established formal and informal processes for reviewing service complaints. The new complaint rules allow the Commission to order corrective actions, and in the instance of deliberate non-compliance, the authority to levy fines.

Even if the Postal Service is successful with all of its cost control and transformation efforts, it appears likely that without legislative relief the Postal Service will run out of cash this year and face serious financial difficulty in 2010 and beyond.

The Postal Service states that it needs legislative relief in two areas to bridge its expected financial shortfalls. First, it has requested an adjustment in its retiree health benefits premium payments. The Postal Service endorses the approach embodied in Representative McHugh's legislation, H.R 22. This legislation takes the approach of suspending the retiree health benefit premium payment for current employees for eight years.

In light of the continuing deterioration of Postal finances and the uncertainty of long-range projections of economic activity and demand for mail, the amount and duration of relief require careful attention. As Chairman Blair suggested to this Subcommittee in March, the Commission believes that a shorter, two-year term of relief combined with a possible adjustment or suspension of the scheduled payment of $5.4 billion into the health benefits fund also merits consideration. If Congress were to adjust or suspend the scheduled payments, it would need to ensure the sustainability of the fund to address the long-term health benefit liabilities.

The Postal Service has also requested the removal of legislative restrictions so it could reduce the frequency of mail delivery from six to five days. The delivery network consists of over 150 million addresses. There is less flexibility in reducing costs in this network, because each address must be served whether there are many pieces to be delivered or just a single letter. Consequently, only half of the delivery costs vary with volume. Current annual appropriations language prohibits the Postal Service from reducing mail delivery from six days a week. Therefore, any proposals to change the frequency of mail delivery must be approved by Congress.

The Commission's study of Universal Postal Service and the Postal Monopoly estimated the net value of switching to five-day delivery to be about $1.9 billion. Since this proposal would result in a nationwide change of service, it would require the Postal Service to bring it before the Commission to conduct a review, solicit public input and issue an Advisory Opinion.

Public expectations are important. In its study on Universal Postal Service and the Postal Monopoly, the Commission found that the public considered frequency of delivery to be one of seven essential elements that constitute the Postal Service's Universal Service Obligation (USO). The USO also includes access, price, service quality, range of products, geographic scope, and user's rights.

These seven elements cannot be viewed only as isolated cost centers. They are essential parts of the USO. The Commission recommends that Congress consider and balance all of the features of universal service as part of any review of changes necessary to preserve a financially sound mail system.

In summary, the Postal Service is in dire financial circumstances due largely to the length and severity of the current recession that has resulted in an historic decline in mail usage. The Postal Service is taking concerted action to lower its costs and to improve efficiency; however, it expects to run out of cash this year and needs help to meet its short-term obligations. The Commission supports the Postal Service in its continuing efforts to streamline its network, and provide more cost-efficient services. The Commission is working with the Postal Service to provide the accountability and transparency that is needed to build support for its agenda of change and to ensure that its requests for legislative relief are considered in full understanding of the circumstances and choices faced by the Postal Service.

This concludes my written statement and I appreciate this invitation to testify. I welcome the opportunity to answer your questions.

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