Testimony of

The Honorable Ruth Y. Goldway,

Commissioner

On Behalf of the Postal Regulatory Commission

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

Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security

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Chairman Carper, Ranking Member McCain, and members of the Subcommittee, thank you for the opportunity to testify on the financial crisis facing the United States Postal Service.

I am honored to be participating at this hearing. As many of you are aware, I have served on the Commission for 11 years, with many opportunities to both support and second guess three different chairs. The Commission acts as both a regulator of the Postal Service and a protector of its role as the Universal Service provider. Striking the appropriate balance is difficult. Articulating such in brief statements is most challenging. This document has been prepared in consultation with Chairman Blair. We are in general agreement on these matters, however with somewhat different emphases.

Others on today's panel have described in detail the financial straits in which the Postal Service finds itself at this time. Suffice it to say that based on the available reports submitted by the Postal Service to the Commission, we expect revenues to be down over $6 billion from last year at the end of the third quarter, an 8% reduction. By the year's end, the Postal Service most likely will run out of cash and not be able to make all of its year end payments, absent Congressional action. To put this in perspective, UPS and FedEx have had revenue declines of 11% and 21% respectively. This is a difficult time for the industry as a whole.

The Postal Service has responded to the revenue loss with the most aggressive cost cutting in its history. In fact, under Postmaster General Potter, the Postal Service has cut costs for several years. Since 1999, 160,000 career workforce positions have been taken out of the system. (This year it is on track to eliminate an additional 100 million work hours.) Whatever the concerns of those of us who evaluated the Postal Service in the 90's, in the 21st Century, management and labor have worked remarkably cooperatively and efficiently to streamline the system.

The Commission is exercising its authority to ensure that savings are not achieved at the expense of service. To date, reports submitted to the Commission by the Postal Service indicate satisfactory levels for delivery. Accurate measurements systems for customer satisfaction and access are being reviewed.

Retiree Health Benefit Fund Liability

Despite its many actions to increase revenue and cut costs, the Postal Service may run out of cash by the end of next month, which marks the end of fiscal year 2009. They need some immediate relief.

Consequently, the Postal Service is seeking legislation to adjust its retiree health benefit payments. This Committee, through its recent approval of S.1507, the Postal Service Retiree Health and Benefit Fund Reform Act, has taken a step towards alleviating – at least for the short term – the Postal Service's financial crisis, while maintaining the long term solvency of the fund.

At the request of the House Subcommittee on Federal Workforce, Postal Service and District of Columbia, the Commission recently examined the underlying assumptions and methodologies used by the Office of Personnel Management (OPM) and the Postal Service Inspector General (OIG) to determine the Postal Service's unfunded liability for its Retiree Health Benefit Fund. Copies of the report were provided to members of this Subcommittee and are available online at www.prc.gov. Hopefully, our analysis will prove helpful in informing the debate should this Committee consider long-term measures to address funding for the Retiree Health Benefit Fund.

In brief, the Commission found that the different purposes of the two valuations led to differing, though reasonable, assumptions and results. OPM, essentially, took a current snapshot of the Postal Service workforce and rolled it forward to establish the liability, which was reported on the Postal Service's 2008 financial statements. OIG made its calculations incorporating expected Postal workforce declines through 2016, essentially creating a snapshot of a much smaller Postal family in 2016, and a smaller liability. The two valuations also assumed different future rates of medical inflation.

The Commission developed an alternate calculation utilizing current industry and government best practices. This produced a long-term liability that could result in over $2 billion in lower payments per year than current law requires. The following chart depicts the three calculations.

Payments to Achieve 73% Funded Status (Dollars in Billions)			
	USPS OIG	**OPM**	**PRC Alternative**
Workforce Assumption	Declining	Fixed	Declining
Health Care Inflation	5%	7%	Graded: 8% - 5%
Average Interest rate on assets	5.35%	6.25%	5.35%
Discount Rate on Liability	6.25%	6.25%	6.25%
FY 2016 Estimated Liabilities	**$90.5**	**$147.9**	**$113.2**
FY 2016 Estimated Assets	103.7	108.7	103.7
FY 2016 Estimated Unfunded Liability	(13.2)	39.2	9.5
2016 Asset Balance for 73% Funded	66.1	108.0	82.6
Fixed Annual Payment	**$1.7**	**$5.5**	**$3.4**

Future Pricing

Looking ahead to FY 2010, the Postal Service expects continued, though moderating, declines in mail volume. This would have significant ramifications for postal revenues. Under the Postal Accountability and Enhancement Act (PAEA), the Postal Service has the ability to raise new revenue through general rate increases, subject to a CPI-based price cap on its market dominant products and to a price floor and market constraints for its competitive products. Following Commission review, the Postal Service exercised its flexibility and implemented general price increases for its competitive products in January and for its market dominant products in May. These increases helped offset some of the revenue lost to declining volume.

Due to recent low inflation in the overall economy, it appears that the Postal Service may have little to no room next year to raise prices for its market dominant products, which account for 90 percent of revenue. To raise prices above the cap, the Postal Service would have to file with the Commission a so-called "exigent" rate case and they would have to demonstrate "extraordinary or exceptional circumstances" to justify exceeding the rate cap imposed by the PAEA.

Prior to 2007, the former Postal Rate Commission reviewed Postal Service forecasting assumptions and methodology as part of its rate analysis. In the new streamlined rate setting processes established by the PAEA, this has not been necessary. Even if the Postal Service does not file an exigent rate case, it may be beneficial for the Postal Service to share its volume forecasting model with the Commission as a general practice.

<u>Further Cost Savings</u>

The Postal Service has responded to the financial burden of employee health benefit payments, PAEA price caps and declining volumes, in addition to the above referenced streamlining, by proposing a significant reduction in its footprint and service levels.

It has submitted to the Commission a proposal for evaluating the possible closures of about 1000 branches and stations. Under the law, the Postal Service is required to seek an advisory opinion whenever it considers embarking on changes that could affect service nationwide. While the Commission does not have power to direct the Postal Service to operate in a particular manner, the public review within the administrative procedures of Docket N2009-1 will examine the adequacy of the Service's analysis and how it will measure the impact of any closure on affected communities and measure the overall quality of service before such closures take place. Further, we will examine the adequacy of notice provided to the public during the Postal Service's evaluation process and the level of consideration public comments are given. The Commission is considering holding field hearings in this case. We will also seek to determine whether the Postal Service will maintain adequate levels of service within the framework of its Universal Service Obligation.

In the event offices are closed, the Postal Service will be required to provide appropriate public notice as set forth in Title 39.

Five-day Delivery

The Postal Service has also requested that Congress lift restrictions currently contained in annual appropriations language that prohibit the Postal Service from reducing mail delivery from six days a week. In a study issued last summer, the Postal Service stated that a one-day reduction could save as much as $3.5 billion a year. The Commission, in its study of universal service released in December 2008, found the savings to be closer to $1.9 billion. Utilizing data for FY 2008, we now estimate savings of about $2.2 billion. In both cases, the amount of savings is reduced because of anticipated modest declines in mail volume as a result of the service reduction. The Postal Service has stated that it is currently conducting a new, comprehensive study of this issue.

Future of Universal Service

Whether it is 5-day delivery, collection box removal or the closure of facilities, the Postal Service is intent on reducing its physical presence. No proposals have been put forward to find new sources of revenue at Post Offices, such as partnering with other public agencies or reinvigorating its brand. The Postal Service's actions bring into question long-held concepts of how the Postal Service fits into the framework of American society. The Commission is well aware from its proceedings of the impact that the Postal Service has on our nation's charities, educational institutions, political processes and the overall flow of information. It was not long ago that the Postal Service demonstrated its ability to be a binding force for the Nation, when it allowed residents of New Orleans to elect a Mayor even though they themselves had been dislocated from the city by Hurricane Katrina.

The Postal Service continues to be an economic pillar for the nation and the world's largest postal system, accounting for about 45 percent of global mail volume. The Postal Service is highly regarded by the American people. In a recent Gallup Poll, ninety-five percent of those polled indicated that it was personally important to them that the Postal Service continue to stay in business.

The Postal Service is at a very uncertain moment in its history. It is contending with historic mail losses driven by an exceptionally difficult economic environment. There is no question, however, that the increased transparency, accountability and flexibility provided by the PAEA have been beneficial. Within the current law, there remains considerable room for innovation. Postal products continue to be shaped by historic class differences, largely in place since the 1920's that may not make sense today. Potentially new markets could be developed around hybrid products that combine characteristics between classes – for example, a standard mail product with guaranteed date of delivery. Opportunities to better use its existing facilities have yet to be explored.

The American public continues to demand effective, reliable and affordable nationwide postal service. Nevertheless, the Postal Service's ability to continue to be self-sustaining is in question. The model of the past four decades – that mail volume growth would be sufficient to support an expanding delivery network, fully fund Postal Service operations and future health care benefit costs and maintain universal service at existing levels – may need to be reexamined.

Chairman Carper, this concludes my written statement. I appreciate the invitation to testify and welcome the opportunity to answer any questions that you or members of the Subcommittee may have.