Postal Regulatory Commission Chairman Dan G. Blair

Statement before the House of Representatives

Subcommittee on the Federal Workforce, Postal Service,

and the District of Columbia

Wednesday, March 25, 2009

Chairman Lynch, Ranking Member Chaffetz, and members of the Subcommittee, thank you for the opportunity to testify at this timely hearing. Today's hearing is intended to examine the U.S. Postal Service's financial stability along with strategies to reduce costs and improve efficiency. The Postal Regulatory Commission serves as the Postal Service's primary regulator and our role is to provide transparency on financial operations, pricing policies, and delivery performance to Congress, stakeholders and the general public.

Today, the Postal Service is facing dire financial difficulties that are likely to worsen before they improve. The current economic crisis has substantially impacted Postal Service volumes and revenues. For example, the financial sector, which has suffered serious dislocation due to the recession, accounted for approximately 15 percent of the U.S. Postal Service operating revenues according to the Postal Service's *2008 Annual Report***.** The economic downturn comes on the heels of continued diversion of single-piece First Class Mail to e-mail and electronic bill payments. The cumulative result of these events has been the most severe volume declines since the Great Depression and significant financial losses for the Postal Service. Postal Service data show volume declines for every domestic class of mail in FY 2008 with First-Class Mail volume declining almost 5 percent. The first quarter of FY 2009 showed continuing volume declines for all classes. First-Class mail declined an additional 7.3 percent and standard mail declined 11.0 percent. In all, total volume in the first quarter declined 9.3 percent.

This trend is continuing into calendar year 2009 at an accelerated rate. Total mail volume in January 2009 was 16 percent below levels reported in January 2008. Further, the Service reported it lost three-quarters of a billion dollars in January 2009. We expect further deterioration in February with continued dramatic volume decreases as well as a significant decrease in revenues. While the Service has taken action to curtail workhours dramatically, it is expected to report a substantial operating deficit for February.

Should double digit volume and revenue declines continue, Commission analysis shows a cash shortfall could be expected by the end of the fiscal year.

The Postal Service has indicated to the Commission that it would suffer a net loss before cost savings of $12.4 billion by the end of this Fiscal Year. To address this situation, the Postal Service has identified internal cost savings of $5.9 billion in FY 2009, leaving a net loss after cost savings of $6.5 billion. Just last week, the Service announced it will close six out of 80 district offices, eliminate 521 management positions across the country, and offer early retirement to nearly 150,000 employees nationwide. Administrative staffing will be reduced by 15 percent in the remaining 74 districts and more than 1400 mail processing management positions will be eliminated in nearly 400 facilities around the country. The Postal Service has said these difficult steps are necessary to address this fiscal crisis. However, these reductions alone are insufficient if the Postal Service is to meet its payroll and other expenses.

The Postal Service announced last month its intent to seek legislative authority to reduce mail delivery to households from six to five days. In the Commission's *Report on Universal Postal Service and the Postal Monopoly,* issued in December of 2008, we determined that if the Postal Service were to make this service reduction, it could save a potential $1.9 billion annually.

Reductions in service, however, carry potential risks. The Commission's Universal Service Report recommended that the Postal Service assess how major mailers might react to such a change in service before the Postal Service implements this type of reduction.

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 appropriations language also places restrictions on the closing of small and rural post offices. In years past, Congress has expressed support for maintaining the status quo in other areas where potential cost savings could be realized. Congress may want to revisit these legislative limitations if it determines that delivery and service reductions are necessary to ensure the future financial viability of the Postal Service.

Congress may also wish to consider raising the Postal Service's total debt limit as another means of addressing the Service's financial situation. However, additional debt would have to be paid back with interest. Currently, the Postal Service has a $15 billion debt ceiling and may increase its debt load no more than $3 billion in any one year. Over the last three years, the Postal Service has increased its long term debt from zero in FY 2005 to $6.5 billion at the end of the first quarter of FY 2009. If the Postal Service utilizes its full borrowing authority for an additional $3 billion this fiscal year, the outstanding shortfall would be $3.5 billion.

In considering strategies to address its financial viability, the Service is seeking legislative relief through an adjustment to its retiree health benefits premium payments. Unlike other federal agencies, the Postal Service is required by law to fund the cost of health benefits premiums for both current and future retirees. The Postal Accountability and Enhancement Act (PAEA) requires the Postal Service to pay into the Postal Service Retiree Health Benefits Fund regularly scheduled payments through 2016. As of September 30, 2008, this fund had a positive balance of $32.6 billion.

The total payment for FY 2009 for retiree health benefits is estimated at approximately $7.4 billion. This includes the scheduled payment of $5.4 billion, as mandated by the PAEA, and an estimated $2 billion for current retiree health benefit premiums.

Given the serious financial difficulties facing the Postal Service, an adjustment to the Service's health benefit payment schedule would appear to be the most pragmatic approach in providing relief for the short term. In principle, prefunding these liabilities is good public policy. However, meeting current obligations and payroll must take precedence.

Options for relief can be fashioned by considering two variables – the dollar amount and duration of the relief.

Representative McHugh's legislation, H.R 22, takes the approach of suspending the retiree health benefit premium payment for current employees for eight years. H.R. 22 has 195 cosponsors. If Congress grants the Postal Service authority to suspend its $2 billion payment in FY 2009 for current retiree health benefit premiums, the resulting savings still would not completely resolve the Service's immediate problem. A potential cash flow problem could result at the end of this Fiscal Year and the outlook for FY2010 is even bleaker.

In light of the continuing deterioration of Postal finances, a broader approach, such as adjusting or suspending in part the scheduled payment of $5.4 billion into the health benefits fund, should also be considered.

At a January hearing before the Senate Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security, I testified that a two-year relief approach should be considered. The two-year approach provides Congress the oversight opportunities to re-examine progress made by the Postal Service in addressing its financial condition and the need for continued relief.

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.

Another possible approach would be increasing the direct appropriation from Congress to cover additional operating expenses. The Postal Service is supported almost exclusively by ratepayers and generated nearly $75 billion in ratepayer revenues in FY 2008. Last year, the Service received $103 million through direct appropriations, covering free mail for the blind, overseas voting, and a reimbursement of prior revenue foregone authorized by the Revenue Forgone Reform Act of 1993.

This challenging financial environment comes at a time that the Commission is working diligently to implement key provisions of the PAEA. The statute directed the Commission to develop a modern system of rate regulation implementing the inflation-based rate cap system and we issued that order establishing the new system in October 2007. The statutory framework contemplated the Service seeking annual adjustments for market dominant products with the increase for each class of mail kept equal to the rate of inflation, as determined by the Consumer Price Index.

In February 2009, the Postal Service filed with the Commission its plan for rate adjustments, effective in May, subject to the inflation-based rate cap. As the members of this Subcommittee know, a key goal of the 2006 Act was striking a balance between the Postal Service's need for additional flexibility with the public and mailing community's need for increased rate stability.

Last week, the Commission issued its review of these price adjustments and found that the increases for market dominant products were on average, within the applicable 3.8 percent price cap for each class of mail. The rate adjustment includes a 2 cent increase in the price of the First-Class stamp, from 42 to 44 cents. Should current inflation trends continue, the price adjustment for 2010 would likely be less than one percent.

In addition to inflation-based adjustments, the Act allows the Postal Service to file an "exigent" rate case to address revenue shortfalls. This authority allows the Postal Service to raise its rates for market dominant products higher than the CPI-based rate cap imposed by the PAEA if it can demonstrate "extraordinary or exceptional circumstances." The Postmaster General has indicated his desire to avoid filing such a case for fear that raising rates above inflation would likely drive more mailers from the system and further diminish future postal volumes and revenues.

Other strategies for improving the Postal Service's financial outlook include examining ways to grow volume and position the Postal Service to take advantage of market opportunities once the economy begins to recover. The Act granted the Postal Service additional flexibilities in seeking negotiated service agreements, as well as new and experimental products. In our FY 2007 compliance determination, the Commission found that NSAs contributed $2.5 million in net benefit to the Postal Service's finances.

At a January hearing before the Senate Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security, I raised the Commission's strong concern about the lack of publicly available, monthly financial reports by the Postal Service. The Act granted the Commission new regulatory power to ensure the financial transparency of the Postal Service. The law also requires the Service to comply with Securities and Exchange Commission-like reporting requirements.

During this time of financial difficulty, timely and sufficient - as well as accessible information on operating results - is crucial. Publicly available monthly reports - to Congress and the Commission - will help keep postal stakeholders abreast of changes in trends and allow prompt reaction to changing circumstances. I firmly believe that, given the tenuousness of the Postal Service's financial situation, more – not less – financial transparency is called for.

I am pleased to report that the Postal Service publicly filed with the Commission its Integrated Financial Plans for Fiscal Years 2008 and 2009 on February 27. The Integrated Financial Plans detail the operating budget for the fiscal year, including the economic assumptions used to develop the budgeted data. Also included are the Capital Investment budget and the fiscal year's financial plan for operations and capital investment.

Additionally, on March 3, the Postal Service filed with the Commission a monthly financial statement for January 2009, which is now available on our website. The monthly report contains basic income statement information and compares the current month data with their operating plan and with the same period last year. It also reports the same information on a year-to-date basis. In addition to an income statement, the report also presents volume information by class, a breakdown of expenses by category, and a report on total workhours used. While we recognize that the information provided in the monthly statement is not audited and can be subject to revision, we feel it will provide stakeholders a clearer and more current picture of the Postal Service's financial status. We will continue to discuss with the Postal Service additional reporting requirements on some of the backup account data for the monthly statements.

Let me also take this opportunity to update you on other Commission activities. For 2009, the Commission's regulatory agenda remains very active. We have finalized or are about to finalize three orders in rulemaking proceedings designed to implement important provisions of the PAEA. The Commission recently issued a second notice of proposed rulemaking to implement procedures governing the degree of confidentiality to accord information filed with the Commission by the Postal Service and third parties. In the next few days, we expect to adopt rules addressing the efficient and expeditious processing of complaints and to approve final rules prescribing the form and content of periodic reports the Postal Service is required to file with the Commission under the law.

The Commission is wrapping up its review of the Postal Service's Annual Compliance Report (ACR). The Commission's review of this report will address compliance of rates and fees under applicable standards, as well as whether service standards in effect during the period covered by the Fiscal Year 2008 ACR were met. This determination focuses on activities of the prior Fiscal Year. The Commission's Annual Compliance Determination will be posted on our website March 30.

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