Testimony of The Honorable Dan G. Blair, Chairman

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.

In my testimony at the Subcommittee's January hearing on the impact of the recession on the Postal Service, I discussed how the Postal Service was in a precarious financial position that was likely to worsen. I wish I could tell you that the situation has improved. However, since that time the monthly reports received by the Commission from the Postal Service have not only confirmed a continuation of the financial difficulties, they reflect an accelerating decline in mail volume that greatly exceeds even prior conservative forecasts. As a result, despite extensive cost cutting efforts by the Postal Service that are expected to save about $6 billion this year, the Postal Service warns it may run out of cash and will not be able to make all of its year end payments, absent Congressional action.

Declining Mail Volume

As an overall indicator of the size and acceleration of this downward trend, the Postal Service entered the year with the expectation that total mail volume would fall this year by about 8.2 billion pieces, as forecast in its Integrated Financial Plan for FY 2009. This expectation was an improvement on the 9.5 billion piece loss of FY 2008, which at the time, represented the biggest yearly mail piece decline since the Great Depression.

The Postal Service now predicts that mail volume will fall by roughly 28 billion pieces this year, 300-percent higher than initially projected. Future assumptions about economic recovery are important factors in determining the steps needed to get the Postal Service back on track. While structural changes in the communications industry and electronic diversion of bills, payments and statements continue to impact Postal fortunes, the current recession has compounded the losses and placed the Postal Service in dire financial circumstances.

First-Class and Standard Mail account for more than 94 percent of mail volume and nearly 80 percent of revenue. Between 2000 and 2008, First-Class Mail, showing effects of electronic diversion, declined an average of 1.2 percent a year, while standard mail increased by an average 1.6 percent. In May (*June and Quarter 3 figures scheduled for release August 5*), standard volumes fell by nearly 24% and First-Class volumes by 16.4 percent compared to the prior year. Every class of mail is down significantly, with the declines accelerating each quarter. Based on available numbers, we project Postal Service revenue to be down about $6 billion through the end of the third quarter.

<u>Commission Activities</u>

The Postal Service is responding to this crisis with a range of actions to stimulate demand for the mail, to lower costs and to position itself better with the mailing industry. The Commission's new rules enable the Postal Service to use its flexibility as envisioned by the Postal Accountability and Enhancement Act (PAEA).

The Commission has reviewed and found to be compliant with the law two major innovations: the Postal Service's first experimental product under the PAEA – Collaborative Logistics – and the Postal Service's first sale of standard mail. The Collaborative Logistics product is designed to allow the Postal Service to increase revenue by selling less-than-truckload (LTL) space on mail transport trucks that currently are operating below capacity. The LTL market is very competitive; however, the Postal Service has an established national network and low cost of entry into the market. The Commission also approved a "Summer Sale" from July through September, whereby larger mailers can earn discounts on Standard mail volumes that exceed historic norms, which would allow the Postal Service to earn incremental revenue and take advantage of excess capacity created by the economic downturn.

Through the end of July, the Commission also has reviewed and approved nearly 50 competitive contracts submitted by the Postal Service for Priority, Express and International Mail products, roughly double the number of such contracts in FY 2008.

In view of declining demand for postal products driven by current economic conditions, the Postal Service is focusing heavily on cost control efforts to deal with its deteriorating financial situation. The Postal Service has set a goal of reducing costs this year by approximately $6 billion, by cutting expenses, reducing administrative overhead, removing mail collection boxes, consolidating delivery routes, adjusting its mail processing and retail networks, and downsizing its workforce. Since 1999, the Postal Service has reduced its career workforce by more than 160,000 positions. This year, the Postal Service is on track to eliminate an additional 100 million workhours.

The Commission is exercising its oversight authority to ensure that savings are not achieved at the expense of service. Currently, the Commission is reviewing, as Docket N2009-1, a proposed process for evaluating whether to close or consolidate stations and branches nationwide in major urban and suburban locations. The law requires the Postal Service to seek an advisory opinion from the Commission whenever it proposes to make changes in its operations that could have a substantial effect on service nationwide. The Commission previously examined a Postal Service plan in 2006 to adjust its mail processing network under Docket N2006-1. During that review process, the Postal Service's plan received public scrutiny, details of the plan were fleshed out, and a number of process improvements were recommended.

The N2009-1 docket is now in the preliminary discovery phase. The Postal Service recently submitted to the Commission an initial list of 677 station and branch offices that have been identified as candidates for discontinuance studies. Over the coming weeks, the Commission and interested parties will examine the processes, issues and facts of the Postal Service Initiative. Initial questions to be answered include: Are there guidelines to ensure that all evaluations are conducted using consistently applied standards? What are the procedures for soliciting input from customers, residents, employees and other stakeholders? And, how will stakeholders be notified in event of a decision to close a station or branch?

Due to the nature of the station and branch initiative, the Commission may consider holding field hearings outside of Washington DC. As with the N2006-1 docket, the Commission expects that greater public review and comment will make the process more transparent and ensure appropriate safeguards to service. In the event that a retail office is closed as a result of this Initiative, the Postal Service would be required to provide appropriate public notice and the Commission would have jurisdiction to review customer appeals under its post office closing rules.

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 will have used all of their available life lines – about $1.4 billion cash on hand from 2008, $6 billion in cost cuts and $3 billion borrowed, the legal limit – and they may be unable to pay all of their year-end obligations.

Consequently, the Postal Service is seeking legislative relief through an adjustment to 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 lower payments 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 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>Five-day Delivery</u>

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.

<u>Future of Universal Service</u>

Whether it is 5-day delivery, collection box removal or the closure of facilities, the Postal Service appears intent on reducing its costs by reducing its footprint. These changes 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.

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 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.