S. Hrg. 107–551

THE POSTAL SERVICE IN THE 21ST CENTURY: THE USPS TRANSFORMATION PLAN

HEARING

BEFORE THE

INTERNATIONAL SECURITY, PROLIFERATION AND FEDERAL SERVICES SUBCOMMITTEE

OF THE

COMMITTEE ON GOVERNMENTAL AFFAIRS UNITED STATES SENATE

ONE HUNDRED SEVENTH CONGRESS

SECOND SESSION

MAY 13, 2002

Printed for the use of the Committee on Governmental Affairs

U.S. GOVERNMENT PRINTING OFFICE

80–598 PDF WASHINGTON : 2003

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
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THE POSTAL SERVICE IN THE 21ST CENTURY: THE USPS TRANSFORMATION PLAN

MONDAY, MAY 13, 2002

U.S. SENATE,
INTERNATIONAL SECURITY, PROLIFERATION,
AND FEDERAL SERVICES SUBCOMMITTEE,
OF THE COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, DC.

The Committee met, pursuant to notice, at 10:02 a.m., in room SD–342, Dirksen Senate Office Building, Hon. Daniel K. Akaka, Chairman of the Subcommittee, presiding.

Present: Senators Akaka, Dayton, Carper, Cochran, and Stevens.

OPENING STATEMENT OF SENATOR AKAKA

Senator AKAKA. Good morning. This hearing will come to order.

This morning, we have a very rare privilege of having two Generals with us and a full house. We are pleased to have with us today John Potter, the Postmaster General, and David Walker, Comptroller General. Both of you have contributed so much to framing our discussion of how to strengthen the Postal Service and safeguard its core mission: Providing universal mail service to all Americans at affordable prices.

Mr. Potter, in the first 11 months of your tenure, the Postal Service has faced events that no one could have foretold. Over the past 10 days, the Service and its employees has once again found themselves on the front lines, and I want to commend them for the courage and determination they showed in response to this latest attack.

All too often, we take them for granted, and I was so pleased when the Senate unanimously adopted a resolution last November, that Senator Boxer and I introduced, that commended Postal employees for their service and dedication. The events of the past 8 months have clearly demonstrated these men and women deserve to be recognized for their courage in the face of substantial risk.

We are also honored to have with us today the Comptroller General, whose commitment to an effective and efficient government has been underscored by his continued personal involvement with oversight of the Postal Service—the work that we are doing. Mr. Walker, I thank you and your staff for spotlighting the serious financial and operational challenges facing the Postal Service and for your recommendation for transformation.

I sincerely believe that we have the right folks in the right place at the right time to assist us with the task of securing the Postal Service's future. I also wish to thank those members of our audi-

ence who worked with the Postal Service as it put together this Transformation Plan. Your cooperation and partnership added exceptional value to what we are doing.

Last March, the leadership of this Subcommittee and the full Committee asked the GAO to review the financial condition of the Postal Service after learning that the Service faced a possible $3 billion deficit for fiscal year 2001. A month later, GAO placed the Service's transformation efforts on its high risk list, and in May, at a joint Committee/Subcommittee hearing, we responded to Mr. Walker's recommendation for a Transformation Plan by asking the Postal Service to provide us with its short-, mid-, and long-term vision. That Plan and the GAO report are the focus of today's hearing.

I do not have to remind any of you that the operation of the Postal Service and the delivery of mail is critical to our Nation's economy. It is the linchpin of a $900 billion mailing industry that employs nearly nine million workers and is 8 percent of gross domestic product.

This morning we will examine the consequences of ignoring the challenges facing the Service, as laid out by the Plan and GAO's report. I believe both reports make a strong case for change and both propose some tough options on tough issues, some of which will be politically unpopular.

I am also aware that given the diverse nature of the mailing industry, it may be difficult to forge a true consensus, but I agree with the Postmaster General that the only way to tackle the future of the Postal Service is through working together.

I will not take any more time to discuss where we have been. Rather, I would like to talk about the Transformation Plan. I appreciate the extent to which the Plan addresses many of the fundamental issues associated with Postal questions and operations, rates and pricing, human resources, regulatory reform, and mail safety. However, within these categories, there were details that were not clearly defined, such as implementation time frames, how proposed cost cutting goals and no rate increases until 2004 will provide adequate funds for capital needs and debt reduction, and how the Postal Service will deal with the long-term liabilities associated with pension plans and post-retirement health benefits while ensuring the retirement security of its employees.

We need fuller explanations of the Service's strategies to improve labor-management relations and how it will enhance workforce culture. How will changes to procurement and contracting procedures produce savings? And how will the Service fund mail safety and security programs beyond Congressional appropriations?

It is also fair to ask why existing flexibilities have been seldom used, and what has changed that makes the Postal Service believe it can now take advantage of the short-term options outlined in the Plan? How do we balance the interests of those who use First-Class Mail with the interests of commercial mailers as the Postal Service seeks additional pricing flexibilities? How do we protect universal service and make sure that the Postal Service's core mission does not erode?

Although we do not have the time to examine all of these issues today, we will seek answers to these and other questions.

Let me conclude by saying that should Congress agree with the recommendation that the Postal Service become a commercial government enterprise, we must protect the institutional and fiduciary interests of the Federal Government, the Congress, and the public. We must consider how a government entity with commercial mandates would function and how we would ensure Congressional accountability and protect against the misuse of Federal funds and authority.

Without strong guarantees of accountability and credible financial auditing to protect the public interest, a future generation of lawmakers will be obligated to reconsider the very issues we will discuss today.

I now yield to our first witness. I ask that you keep your oral statements to 5 minutes. Be assured, however, that your written testimonies will be made a part of the record. Again, I express my gratitude for your presence this morning. Postmaster General, please proceed.

TESTIMONY OF HON. JOHN E. POTTER,[1] POSTMASTER GENERAL, U.S. POSTAL SERVICE

Mr. POTTER. Good morning, Mr. Chairman. Thank you for the opportunity to speak with you today about the transformation of the U.S. Postal Service.

One year ago, the Congress asked the Postal Service to create a comprehensive Transformation Plan that would chart its current and future mission and the reforms that would be necessary to fulfill that mission. We delivered that plan to Congress 1 month ago.

In developing the Plan, the Postal Service Board of Governors and Postal management reached out to our stakeholders, the mailing industry, Postal unions, our management associations, and individual consumers. We received their input and recommendations on the future of the Postal Service. There was consensus among this very diverse group that the Postal Service must change if it expects to continue to provide universal service to all Americans. Our Transformation Plan maintains our commitment to that core value, that is, to provide access to postal service and daily delivery for all Americans, regardless of where they live, where they work, or their economic circumstances.

It was that national mandate to provide universal service that led to the establishment of a network of post offices throughout the original 13 colonies. Today, we preserve that commitment by providing a national communications network that connects 280 million people, 105 million households, and 13 million businesses across America through some 38,000 post offices, stations, and branches.

Throughout our 225-year history, the Postal Service has adapted to meet the changing needs of our customers. The circumstances we find ourselves in today necessitate a reevaluation of our operations and the business model which governs us. Today, we are experiencing extraordinary declines in mail volume and resulting losses in revenues. Our projected volume decline for this year will

[1] The prepared statement of Postmaster General Potter appears in the Appendix on page 39.

be more than six billion pieces of mail below last year. That is the largest volume decline ever experienced in a single year.

Despite this decline, we are working to reduce our net loss below our earlier projections. To achieve this, we will reduce the number of career employees through attrition by 20,000 people this year. In addition, we will cut over 60 million work hours compared to last year, and we are postponing program expenditures and delaying capital investments.

The net effect of these actions will reduce current year planned expenses by $2 billion. Those savings, combined with the $1 billion infusion of revenue from the early implementation of the rate case, means our projected net loss for the year will be in the range of $1.5 billion instead of what easily could have been a loss of $4.5 billion.

But these circumstances dictate that we must take a more comprehensive approach to address these issues in the future. That approach is presented in our Transformation Plan. The Plan identifies three parallel courses of action: First, initiatives to improve service and efficiency under current legislation; second, moderate regulatory and legislative change needed to better manage today; and finally, comprehensive legislative reform which addresses complex issues, such as a definition of universal service. Let me take a moment to discuss each.

Internally, we have to balance the need to grow volume with the need for efficiency to assure affordable rates. In short, we must increase the value of our products. Value starts with service. Timely delivery remains our No. 1 priority.

In addition, we have begun to leverage our experience with technology to enhance our products and services. For instance, we have introduced the first intelligent mail product, called Confirm, that enables mailers to track their letters or flats through each step of the Postal Service distribution process. This tool gives mailers information to plan marketing strategies and sales based on more predictable and reliable mail delivery.

The second element of value is price. By law, we are required to set prices based on costs, which is why we have embarked on a 5-year plan to reduce costs by $5 billion through 2006. Our plans include the use of technology to automate operations, facility and transportation network changes, and establishment of a customer-focused, performance-driven culture.

I would add, Mr. Chairman, that we continue to work closely with representatives from mailers' organizations, citizens' groups, and our unions and management associations to solicit their input and support for these initiatives.

Concurrent with this effort, we have focused on immediate, moderate regulatory and legislative changes. Our No. 1 priority is to modify the rates process to be more compatible with the needs of our customers and to provide management with the flexibility to grow the business. We have joined with the Chairman of the Postal Rate Commission, George Omas, to convene a joint summit of all stakeholders in the mailing industry later this month. While this effort may produce some positive results, a moderate change in legislation will assure that the will of the people, as determined by

its elected representatives, is carried out and that protection of universal service is assured.

To that end, the Transformation Plan calls for a comprehensive legislative change to address the future needs of the Postal Service. There are many complex public policy issues, such as the definition of universal service and the Postal Service's business model, which require careful evaluation.

While there were many alternatives for consideration, the Transformation Plan lays out three possible scenarios for our future. We have provided two scenarios that are at the far ends of the spectrum of alternatives available, putting the Postal Service back on budget as a traditional government agency at one end, or creating a privatized corporation at the other end.

In addition, we provided another scenario for converting the current business model to a Commercial Government Enterprise. This third model, a Commercial Government Enterprise, would provide the tools needed to ensure universal service for the American public and long-term financial stability. Essentially, the Postal Service could become profit-driven, generate returns to finance capital projects instead of increasing our debt load, introduce flexible pricing based on market demand, and develop better relationships with our employees.

These and other long-term changes to transform the Postal Service can only come with legislative reforms. Every American and every policy maker has a stake in Postal reform and transformation. The mailing industry of this country employs over nine million Americans. It contributes $900 billion to the Nation's economy, representing 8 percent of the gross domestic product. This national asset must be protected and preserved. We look to this Subcommittee, the Congress, and the administration to help and guide us toward that goal.

Finally, I want to take this opportunity to thank the American public for their support in helping us respond to the recent mailbox bombing incidents in the Midwest. Residents in rural areas helped by opening their mailboxes to minimize risk to our letter carriers and themselves. Our employees deserve credit, too, for their courage and commitment to deliver the mail under difficult circumstances. Their actions brought new meaning to our commitment to provide universal delivery service to America.

I also want to acknowledge and thank the many local, State, and Federal law enforcement authorities who worked to resolve the mailbox bombing incidents. I especially want to thank Acting Chief Inspector Jim Rowan for helping coordinate all our resources and getting 150 Postal inspectors deployed throughout the Midwest to help in the investigation.

In reviewing the news accounts of last weekend, I was reminded that the American people place a high value on the daily delivery of their mail. It is that value that underscores the importance of universal service and the need to change the Postal Service. To that end, my staff and I would be pleased to work with this Subcommittee in any way possible to advance the transformation of the Postal Service.

Thank you, Mr. Chairman. I would be pleased to respond to any questions or suggestions you might have.

Senator AKAKA. Thank you very much for your statement. We certainly look forward to working together with you.

I would like to call on my friend for any statement he may have, Senator Cochran.

OPENING STATEMENT OF SENATOR COCHRAN

Senator COCHRAN. Mr. Chairman, thank you very much. I am pleased to join you this morning to hear the presentation by the Postal Service, the Postmaster General specifically, of his Transformation Plan and his observations about the challenges that face the Postal Service, and to welcome David Walker, Comptroller. We appreciate very much your cooperation with our Subcommittee.

I know that many of us, particularly Postal Service employees, long for the good old days when the worst thing that could happen to you if you were a Postal employee was to be bitten by a dog. [Laughter.]

But the fact is, in this current environment, you can be anthraxed or pipe-bombed and confused with changing trends and demands in the marketplace. We are in a very fast transition phase, it seems to me, in terms of the business challenges that face the Postal Service, and I use that term "business" because I can remember when I used to talk about the fact that we have to realize that the Postal Service is really not a business. It is a service. It is the U.S. Postal Service. It has a greater and larger responsibility to the people of this country.

So it is a unique challenge that the people who run the Postal Service face. It is not just one or the other. It is a combination of an entity that has to comply with the strict mandates of Federal law. It is independent from government. Congress really is not supposed to run it and meddle in its business, but it tends to all the time anyway. So there are a lot of anomalies when it comes to trying to figure out how to proceed to improve and fulfill the missions and the challenges of the future that I think the Postmaster General has really articulated in his statement today very well.

Reducing costs is a priority. Improving the reliability of services, that is a must, reaching out for advice from those who use the services out of the U.S. Postal Service, and realizing that we have to embark upon some commercial realities, government enterprises. The use of the phrase "commercial government enterprise" is interesting and challenging. I think we need to commit ourselves as a Subcommittee to working with you and trying to figure out ways to improve the basic underlying laws and restrictions that apply to the Postal Service.

I am willing to commit to you my best efforts, and I am sure others of the Subcommittee and Congress will join me in that commitment today. Thank you.

Senator AKAKA. Thank you very much for your statement, Senator Cochran.

I would like to call on Senator Dayton for an opening statement.

Senator DAYTON. Thank you. Nothing at this time, Mr. Chairman. Thank you.

Senator AKAKA. Senator Carper, any statement.

OPENING STATEMENT OF SENATOR CARPER

Senator CARPER. Thank you, Mr. Chairman, and to the Postmaster General and to the Comptroller General, welcome, both of you. We thank you for your presence here today. We thank you for your good work, as well.

I grew up in Danville, Virginia, and had a newspaper route in the mornings and in the afternoons. Later on, my stepson would deliver newspapers in New Castle, Delaware. If you go back to Danville, Virginia and New Castle, Delaware today, you do not have kids delivering newspapers anymore. It is a sign of the times.

I think what your employees have been through in the last 6, 7, or 8 months with respect to the anthrax, the chemicals in the mail, and more recently the bombings in the Midwest, is a sign of the times, as well, and not a very good sign of the times.

Postmaster General Potter, I would just ask that you convey to your employees our continued thanks for their service to all of us in what we know are challenging, challenging times.

I think the attacks I mention may have come at what is perhaps the lowest point in the Postal Service's 30-year history. Volume is down. Revenues are down. Deficits are growing and fixed costs are not going away. Some of the customers who left the Postal Service because of safety concerns in recent months may come back as the economy continues to recover. Others may never return and it is possible that the Postal Service would have lost a good number of them in any event.

As the Transformation Plan that you submitted points out, the Internet is already eating into volume and will continue to do so in coming years as younger generations who are more comfortable with technology take advantage of innovations like electronic bill pay. I just paid my bills this weekend. It was interesting to note, and I thought about this in anticipation of today's hearing, how many of the bills we pay now through electronic billing that we used to put stamps on the envelopes and pop them into the mail on Monday mornings. Obviously, we are not the only family that does that.

So what do we do? What do we want our Postal Service to look like in the Internet age? These are questions we have to answer or else the circumstances will answer them for all of us. As GAO has pointed out, the Postal Service cannot simply continue to do business the way it has been doing it and continue to survive and prosper.

One thing that we do need to think, I believe, long and hard about in Postal reform is whether to allow the Postal Service to become a "communication company," as it has taken to calling itself recently. The Postal Service is in the mailing business and should stick to what it does best, I think, and that is delivering the mail. Offering e-commerce services and selling greeting cards and stationery in the post office might be in some ways a little more exciting, maybe more challenging than delivering letters and packages, but we need to ask ourselves, will it improve the Postal Service's bottom line and can it be done in a manner that is fair to the Postal Service's private sector competitors?

Making smart management decisions aimed at increasing volume, raising revenue, cutting costs, and capitalizing on quick, effi-

cient delivery of the mail will improve the bottom line, and that is for sure.

A number of years ago, I went to business school and we did case studies, as a lot of students in business schools do, and I told my staff in anticipation of this meeting, Mr. Chairman, that if I were the person responsible for running the Postal Service, and particularly with the business school bent, I would be trying to figure out how to reinvent the company and probably how to turn it into a communications company. Doing so, however, may not be fair to the private sector companies with whom you compete for the non-monopoly business, and doing so may not be fair to those of us who pay for First-Class Mail and may be paying actually more than our fair share of the costs in order to cover the non-First-Class Mail.

I believe, and we will get into this in Q&A, I believe that about 50 percent of your revenues come from First-Class Mail. Those revenues cover maybe 70 percent of your operating costs, your institutional costs. That is a point I want to come back to a bit later.

Mr. Chairman, I have a couple more things that are in my statement. I would ask unanimous consent that those comments be added to the record, and again, we thank our witnesses and look forward to just a real good dialog with you. Thank you.

[The prepared statement of Senator Carper follows:]

PREPARED OPENING STATEMENT OF SENATOR CARPER

Thank you, Mr. Chairman and thank you General Potter for being here today to talk about the *Transformation Plan* the Postal Service submitted to Congress last month. Let me also thank you for your service to our country during what has been a difficult time for the Postal Service and postal employees across the country. Through the threat of biological attack and, most recently, bombs in mailboxes, you've all been vigilant in carrying out your mission—connecting America through the mail. I think I speak for all of my colleagues on the Subcommittee today when I say that your work is greatly appreciated.

Unfortunately, the attacks I mention have come at what has to be the lowest point in the Postal Service's 30-year history. Volume is down, revenue is poor, deficits are growing and fixed costs are not going away. Some of the customers who left the Postal Service because of safety concerns in recent months may come back as the economy continues to recover. Others may never return, and it is possible that the Postal Service would have lost a good number of them anyway. As the *Transformation Plan* points out, the Internet is already eating into volume and will continue to do so in coming years as younger generations who are more comfortable with technology take advantage of innovations like electronic bill pay.

So what do we do? What do we want the Postal Service to look like and do in the age of the Internet? These are the questions we have to find the answer to, or else circumstances will answer them for us. As GAO has pointed out, the Postal Service simply cannot continue to do business the way it has been and hope to survive.

One thing I think we should not do in postal reform is to allow the Postal Service to become a "Communications Company," as it has taken to calling itself recently. The Postal Service is in the mailing business and should stick to doing what it does best—delivering the mail. Offering e-commerce services and selling greeting cards and stationery in post offices might be more exciting than delivering letters and packages but it will not improve the Postal Service's bottom line. Making smart management decisions aimed at increasing volume, raising revenue, cutting costs and capitalizing on quick, efficient delivery of the mail will.

Congress has a role to play in digging the Postal Service out of the hole it finds itself in. Our aim should be to allow the Postal Service to operate more like a business but in a way that is fair to its private sector competitors. First, we need to reform the rate-making process to give the Postal Service the flexibility to offer volume and seasonal discounts that would increase volume and even to raise rates in high volume seasons or in the event of an energy crisis. We need to remove the break-even mandate and allow the Postal Service to retain earnings that could be invested in new technologies or saved for a rainy day. We may also need to look

into removing the constraints we place on the Postal Service every year during the appropriations process that require them to maintain expensive facilities and small post offices that they may need to carry out their mission.

Most of the heavy lifting in the short term, however, will have to come from the Postal Service itself. I was pleased that the *Transformation Plan* took a step in the right direction by putting forward some strong proposals aimed at cutting costs and improving operational efficiency. One thing I'd like to learn from General Potter today, however, is where exactly the $5 billion in savings the Plan says it will generate through 2006 will come from.

All that being said, the toughest decisions Congress and the Postal Service will have to make in the coming months will be on what universal service should mean next year, or even 10 or 20 years from now when the pace of electronic diversion begins to quicken. Some easy answers would be to go to a shorter delivery week, to cut back service in hard-to-reach rural areas or to weaken delivery standards. I can't profess to be an expert on postal issues but I truly believe that actions like these, while they should be examined, may weaken the Postal Service instead of strengthening it. Our overarching goal in postal reform should be to preserve as much of the promise of universal service as possible, not to preserve the Postal Service at its current size and under its current construction at all costs. Cutting service and raising rates to finance an inefficient Postal Service will only drive more customers away.

In closing, let me say that its time for all of us, both here in Congress and in the mailing community, to get serious about the problems the Postal Service faces. The postal economy is too large and the number of jobs that depend on the mail is too high for us not to act. I congratulate the Chairman and Ranking Member on this subcommittee, Senators Akaka and Cochran, and Senators Lieberman and Thompson on the full Committee for doing their part in calling this hearing today and in asking the Postal Service to prepare this Plan we have before us. I also urge postal stakeholders—the unions, the mailers and the Postal Service's private competitors—to recognize that, while they may not like some of what postal reform will inevitably mean, compromises will have to be made. If we don't work together now, there may not be much left of the Postal Service to reform. Service should be our focus, not any one group's narrow interests. If we don't keep this in mind, I think we'll all lose. The businesses and everyday Americans who depend on the mail, however, will lose the most.

Thank you again Mr. Chairman. I look forward to hearing from the witnesses.

Senator AKAKA. Your statement will be included in the record.

Now, I would like to ask the Comptroller General for your testimony.

TESTIMONY OF HON. DAVID M. WALKER,[1] COMPTROLLER GENERAL, GENERAL ACCOUNTING OFFICE

Mr. WALKER. Thank you, Mr. Chairman and Senators. I am pleased to be here today to participate in this hearing on the financial condition of and transformation challenges facing the U.S. Postal Service.

As you know, it was about a year ago that I appeared before this Subcommittee and we talked about the challenges that the Postal Service faced at that point in time. It was immediately after the GAO put the Postal Service's transformation effort on our high risk list. As you know, our high risk designation normally generates light, with light, you get heat, and with heat, you get action.

I am pleased to say that there has been a variety of actions taken during the last year, the most recent being the Service's promulgation of its proposed Transformation Plan, which I think is a positive step. I think in many cases, the Transformation Plan exceeded the expectations of many parties. It represented a good faith effort to be able to address the nature and extent of the problems

[1] The prepared statement of Mr. Walker appears in the Appendix on page 46.

that the Postal Service faces and it also employed a three-step approach.

What can management do within the context of current law? What type of incremental legislative reforms might be helpful to the Postal Service to provide it with some additional flexibility, additional empowerment, and reduce some barriers, while at the same point in time coupled with appropriate transparency and accountability mechanisms to go with that? And what needs to be done on a long-term basis to deal with the fundamental transformation challenge that the Postal Service faces?

Its current business model does not work in the 21st Century. Let me state that again. The Postal Service's current business model does not work in the 21st Century and will not work in the 21st Century. So there are fundamental questions that have to be addressed.

At the same point in time, there are some key things that we think need to be addressed that were not in the Transformation Plan, a few key topics as well as an action plan, not only what needs to be done, but how to do it. What are the mechanisms that need to be done and what are the important milestones that can help to gauge progress?

Mr. Chairman, you have been kind to include my entire statement in the record, let me hit a few of the highlights that I think it is important to keep in mind.

Obviously, the catastrophic events of September 11 and the subsequent use of mail to transmit anthrax, as well as the most recent pipe bombings, have changed the ballgame fundamentally. They have served to decrease mail volume and they have served to increase the cost of the Postal Service, and only time will tell how much of this decreased volume and how much of this increased cost is long-term versus short-term in nature.

Despite additional cost cutting efforts in the first half of fiscal year 2002, the Service's revenues declined approximately twice as fast as its expenses, in part because the Service has large fixed expenditures that are very difficult to change quickly.

Productivity increases continue to be difficult to achieve and sustain. As you know, recently, the Postal Service has been granted a rate increase to be effective on July 1. That will, among other things, end up increasing First-Class postage to 37 cents, an increase of three cents. I think while over a number of years, if you look over several decades, the Postal Service rate increases for First-Class Mail have equaled inflation. However, if you look since January 1999, its rate increases have far outpaced inflation, and if you look at what some of the underlying pressures that the Postal Service faces, that is likely to continue to be the case in the future unless the Postal Service is successful in achieving the fundamental transformation that we are calling for.

Cash flow difficulties continue. The Service's debt is budgeted to rise to $12.9 billion by the end of fiscal year 2002, up $1.6 billion from the previous year, and only $2.1 billion below the statutory cap of $15 billion. To conserve cash and to limit debt, the Service has continued to freeze its capital spending for most facility projects, resulting in a growing backlog, and that is just a timing

difference. Sooner or later, you are going to have to deal with it, and sometimes delays conserve to exacerbate the problem.

The Service's financial condition has deteriorated. Its liabilities exceed its assets. It has a negative net worth. The Service's major liabilities and obligations are estimated at close to $100 billion, which include liabilities for pensions, workers' compensation, debt to the Treasury, and certain other obligations for Postal retirement health benefits.

While some of these amounts are reflected on the balance sheet of the Postal Service, some of these amounts are not. For example, $49 billion in unfunded retiree health benefits are not reflected on the balance sheet. In addition, they are not adequately disclosed in the notes. In addition, there is a $32 billion number that is reflected as a pension liability, but it is also reflected as a deferred asset, therefore netting out to zero with regard to the Postal Services overall financial condition.

Mr. Chairman and Senators, I am very concerned about whether or not the current accounting treatment for Postal retirement health obligations and pension obligations fairly presents the economic reality associated with the Postal Service's commitments with regard to these programs. I have brought this to the attention of Postmaster General Jack Potter as well as the Inspector General. We are trying to contact the external auditors, and I expect this is an issue that we are going to be talking about over the next several weeks. But the fact of the matter is that these are significant sums that, depending upon what the resolution is, could significantly change the net financial condition of the Postal Service today as well as the factors that will impact future rate increases and a variety of other factors looking forward.

The Service's financial difficulties are not just a cyclical phenomenon that will fade as the economy recovers. Its basic business model does not work. It is facing increasing competition, including from the two things that are on my belt. Through my wireless e-mail device, I get e-mail and can tap into the Internet, and through my cell phone, I can make unlimited calls nationwide to be able to keep in touch with parties, whether for business or personal reasons, rather than sending a letter, as was the case in the past.

Clearly, a range of stakeholders are looking for positive and constructive ways to work through the difficult Postal transformation issues and the Postal Service's Transformation Plan is a positive first step. It is clear, however, that real transformation will require tough choices, shared sacrifices, and that it is unrealistic to expect that, given the complexity and the controversy associated with these issues and the difficulty associated therewith, that there will be a consensus on a plan forward, and, therefore, tough choices will have to be made.

However, we believe that the Service's worsening financial condition and outlook intensify the need for Congress to act on meaningful Postal reform and transformation legislation. We believe that comprehensive legislative change will be needed to address certain key unresolved transformation issues, some of which have not been fully addressed by proposed legislation or the Service's Transformation Plan.

Meanwhile, the Service's growing financial problems call for continued close Congressional oversight of its financial condition, progress, and meeting its Transformation Plan. We believe that it is important that there be greater transparency on a quarterly basis regarding to where the Postal Service stands with regard to its financial results, where it stands with regard to its Transformation Plan along the lines of what you would expect from a $67 billion a year enterprise, one of the Nation's leading employers, and if it was a Fortune company, would be a Fortune 10 company.

The Congress's strong support for the Service to develop the Transformation Plan, and this Subcommittee's in particular, has helped to move the discussion forward. We look forward to working with the Congress to try to deal with these very difficult issues.

Mr. Chairman, thank you again for the opportunity to appear. I will be more than happy to answer any questions you or the other Senators may have. Thank you.

Senator AKAKA. Thank you very much, Comptroller General, for your candid statement.

I would like to ask my friend, Senator Stevens, for any statement you may have.

OPENING STATEMENT OF SENATOR STEVENS

Senator STEVENS. You are very kind, Mr. Chairman. I am sorry to be late. I do not have any questions. I am pleased to be able to be here for this annual event. No State in the Union has more interest in the continued health of the U.S. Postal Service than my State. Without any basic road system, the Postal Service delivers our mail literally through hail, sleet, and snow, and we are pleased to have an opportunity to work with the Postmaster General and I appreciate Mr. Walker's report. Thank you very much.

Senator AKAKA. Thank you very much, Senator Stevens.

Let me begin the first round of questions by asking the Postmaster General to detail the consequences if the short-term options proposed in the Transformation Plan are not adopted. I would also like to know what the consequence will be if the Service reaches its statutory borrowing limit of $15 billion.

Mr. POTTER. Let me begin with the borrowing limit. Obviously, it is my job and the job of everyone in the Postal Service to make sure that we do not reach that borrowing limit. The Board of Governors of the Postal Service has been very clear in its direction to Postal management that we are not to exceed that borrowing limit. By law, we cannot, and we are not to seek relief from that because that simply pushes the cost of providing today's service on future ratepayers.

I can assure you that we have no intention of hitting that borrowing limit this year. Our plans would result in us not approaching that borrowing limit next year, and it is our job to make sure that we do not do that, not only in the near future, but in the long term.

As regards what we are doing today, our short-term plans, obviously, there are many things that we built into the Transformation Plan that we in the Postal Service can control, particularly when it comes to efforts to improve the value of the mail, both from a service standpoint as well as a cost standpoint. We are very proud

of the efforts of the men and women of the Postal Service, particularly this year, to reduce our costs.

We have had eight accounting periods thus far in our fiscal year. The first accounting period, our total factor productivity was a negative 2.9 percent. That was the period right after September 11. Then we had our accounting period five, which is just post–Christmas, where we had a negative 0.9 percent total factor productivity. In every other accounting period, our total factor productivity has been positive, and year-to-date, our total factor productivity is positive. It is 0.2 positive. Our labor productivity, output per work hour, is up 1 percent.

So we are managing the business. Our employees understand the challenge that faces the Postal Service. They are responding to that challenge, and given the fact that we will lose some six billion pieces of mail this year, I think our people, right on down to the clerks, mail handlers, carriers, rural carriers, are doing their part to make sure that the Postal Service remains efficient.

We do need help, and we are seeking short-term legislative help, particularly in the area of pricing, because there we feel that there are opportunities to grow the business and we are exploring those with the Rate Commission. We think there are opportunities to improve the relationship between the Postal Service and our unions. We spend some $300 million a year on dispute resolution. That certainly represents an opportunity where, working with our unions and management associations, to address those costs to see whether or not we can bring them down.

So we are embarked on a very aggressive plan, what we can do within the current legislation. Beyond the current legislation, we are seeking help, but believe me, we are going to work as hard as we can, regardless of what happens, to do our best. The more tools that are available to Postal management, the greater our opportunity will be to succeed in the short run.

Senator AKAKA. Mr. Walker, last spring, the GAO placed the Postal Service's transformation efforts on your high risk list, as you have stated. What should the Service do to move forward and make progress on implementing the actions called for in its Transformation Plan, and would taking these actions remove the Postal Service from the high risk list?

Mr. WALKER. First, Mr. Chairman, I think that Postmaster General Jack Potter and his management team, working with other stakeholders, including the Board of Governors, are taking this seriously and they are trying to do what they can within the context of current law to try to achieve cost reductions, to enhance productivity, while at the same point in time improving service.

I do, however, believe that they cannot do it alone. I believe that legislative changes are in order. Specifically, some additional flexibility, additional transparency and accountability, and other issues have to be addressed by elected officials, issues such as what is the definition of universal postal service in the 21st Century?

Clearly, as Senator Stevens pointed out, there are areas of this country that rely very heavily on the Postal Service, and whatever that definition of universal postal service is, the Postal Service has to meet it irrespective of the cost, irrespective of the geographic proximity. But now, today, I would respectfully suggest, given the

advances in technology and alternative means of communication, the definition should be fundamentally different than it was in the 1700's when the Postal Service was created.

I also think that it is important that other key issues be addressed, as well, that are not in this transformation effort, and importantly, there is going to have to be a vehicle to achieve this type of change. We have said before that we think that some type of commission is likely to be necessary in order to be able to make a package of recommendations that the Congress can consider as a package, possibly for an up or down vote, because of the difficult choices that are going to have to be made.

The infrastructure has to be rationalized. There is a difference between points of service, which arguably should be more numerous than they are now, and bricks and mortar, which, hopefully, you would want to minimize the amount of bricks and mortar, not only for cost reasons, but for security and safety and various other reasons.

In summary, I think that there are things that the Postal Service can and should do within the context of current law, but I do not think there is any question that legislation is going to be necessary and that probably some sort of commission is going to be necessary to address some of these more fundamental questions where there are legislative constraints or other constraints that exist.

Senator AKAKA. Mr. Potter, as you know, our request for a Transformation Plan was prompted by the need to have a more complete and accurate picture of the Postal Service's financial situation. One of our primary goals was to learn how the Postal Service planned to reduce its outstanding debt, an issue that is of serious concern to the Treasury Department, as well. Would you comment on why the Plan did not provide specific details on how the Postal Service will reduce its debt or offer benchmarks to judge the Postal Service's progress?

Mr. POTTER. Mr. Chairman, when we put together the Transformation Plan, it was during a very trying period for the Postal Service. Earlier projections for this fiscal year called for the Postal Service to have some 212 billion pieces of mail this year. Right now, our best estimate is that we will come in somewhere around 200 billion pieces of mail.

Given the circumstances, it is very difficult to understand whether or not the changes, as the Comptroller General earlier said, that we have seen, particularly at the beginning of this fiscal year, are structural or whether they would rebound. So it was very difficult for us to make any sort of accurate projections on where volume was going to go long-term.

Suffice it to say, though, that there are serious challenges facing the Postal Service. The diversion of First-Class Mail to electronic medium is potentially as high as $18 billion. The timing of that diversion is in question, and certainly if we had gone back 5 years, there are many people who would have expected that the diversion would have happened at a much more rapid pace than it has over this past 5 years.

So it was difficult in terms of being able to project into the future what our volumes would be, and considering the circumstances that we found ourselves in over the last 6 months with the threat

of anthrax, the great impact on the economy that we have seen, and the recessionary period that we find ourselves in.

That is not to say that we are not working to develop better projections, and certainly there are limitations within the current legislation for us to reduce our debt load. We are taking actions that we feel are possible in terms of improving productivity as well as our efforts to increase our volumes. But we are very much limited in terms of our ability under the current legislation to be much more aggressive than we have been.

Senator AKAKA. Mr. Potter, I thank you for your response. As you know, I believe the Service's financial house must be in order before the Postal Service is granted greater flexibilities and I want to be as helpful as possible in this regard.

Mr. Walker's testimony points to the need to focus on the transparency and accountability issues. I would, therefore, ask that before we hold our annual hearing to receive your report to the Senate this fall, we have a detailed step-by-step plan as to how the Postal Service will reduce its debt and what further steps the Service will take to provide greater transparency of its finances. This will increase our understanding, I believe, of Postal finances, and I thank you for your responses.

Let me then move on to questions from Senator Cochran.

Senator COCHRAN. Mr. Chairman, thank you very much.

General Potter, you mentioned in your presentation of this Transformation Plan the necessity to have a transition to a less monopolistic and more competitive organization, but you also suggested in the long term some parts of the Postal monopoly are liable to remain. How important is this retention of the monopoly on letter mail, and in order for the Postal Service to be transformed, should this, too, be changed?

Mr. POTTER. One of the strengths of the Postal Service, the key strength, is the universality of the service that we provide to all Americans. Our ability to offer uniform rates, affordable rates, to all Americans is contingent upon, in my opinion, having a monopoly, which we do today, for letter mail. Lack of a monopoly would have competitors coming in and literally skimming the cream off the top. They would serve big cities at a reasonable price but would not serve rural communities, and certainly people in Alaska and remote parts of Hawaii would not have access to affordable services.

So, therefore, I believe it is very important that the Postal Service have a monopoly. Again, that is the will of the people, and it is there in law today. I think there were a lot of very sound reasons why a monopoly was created for that product, and I believe, looking into the future, that those reasons for the establishment of a monopoly for letter mail are probably stronger today than they have ever been in the past.

But I do feel, on the other hand, that the Postal Service does need to look at its infrastructure. These are public policy decisions for which we need guidance from the Congress, from the administration, from the Senate regarding where we go in the future, and that is why in the Transformation Plan we look to those decisions to be made in a legislative arena, not with the Postal Service making independent decisions, but with the will of the American public

to be the driving force behind the future of the Postal Service and the definition of universal service.

Senator COCHRAN. In that connection, there is a statement in the executive summary that universal service could be defined under contract, a contract between the Postal Service and the government. Do you see any difference between the current universal service obligation and the Postal Service's performance of universal service as a commercial government enterprise?

Mr. POTTER. It is very interesting. If you ask ten people what the definition of universal service is, you tend to get 10 different answers, so we have to start with a clear definition of what that is. In my mind, universal service is 6-days-a-week delivery to every delivery address. It is a uniform rate across the country. And by law today, it is the existing infrastructure of 38,000 post offices. It is that infrastructure that we are talking about when we define universal service.

Now, as we look to the future, there are within each of those definitions opportunities to save money and keep rates affordable, but also, in some cases, to make changes that would improve the service offerings that people have.

I was pleased to find a GAO report from the 1970's, as an example, that looked at post office closings. They said that in the evaluation of some of the post offices that were closed at that time, that the level of service that was provided to those customers or those post offices actually increased customers did not have to pick up their mail at the post office, because we delivered mail to the door of the customer. Rural carriers sell stamps. They are literally a post office on wheels. So rather than forcing a customer to come to the post office, we actually brought the post office to each of those customers.

So, again, I think we have to look at those opportunities and carefully evaluate how we provide service today to the American public that is different than what might have been provided in 1970, and a change in the law is required. A redefinition, given today's marketplace, of universal service, I think, would be beneficial not only to the Postal Service but to the American public as well.

Senator COCHRAN. We are all aware of the anthrax challenge and these other threats of terrorism and the realities of terrorism, and you talk about the inevitability of increases in costs. How much of the financial difficulty that the post office faces now can be attributed to the terrorism threats and the reality of the terrorism acts that we experienced after September 11?

Mr. POTTER. I am very proud of the fact that the confidence that the American public has in the mail has bounced back. We saw a significant decline in people's confidence in the safety of mail shortly after the anthrax incidents, but that confidence in the mail has bounced back.

I believe that when one looks at the volume decline that the Postal Service has experienced this year, you can point to two factors. The first factor is that, certainly, the incidents of September 11 had an impact. But if you look at us today, the recession is the No. 1 issue affecting mail volume. One part of that recession is the very weak advertising economy, because about 10 percent of First Class-Mail is advertising mail. Our volume of First-Class Mail

dropped more than 2 percent initially after September 11. We are back to same-period-last-year (SPLY) levels on First-Class Mail. For advertising mail, though, we are still seeing a 3 percent decline from SPLY. Certainly, there has been diversion to electronic medium over that time, but the bigger impacts have been the recession, the downturn in the economy, and particularly within the economy, the tremendous impact on advertising.

Senator COCHRAN. Let me turn now to the Comptroller General. Mr. Walker, it was your idea when you testified before our Subcommittee that a Transformation Plan ought to be developed, and because of that, we sent a letter to Mr. Potter asking that he provide us with a Transformation Plan. Senators Akaka, Thompson, and Lieberman joined me in making that request.

Do you see this as a plan that is responsive to the suggestions that you made and responsive to the reasons that you had in mind why a Transformation Plan ought to be formulated and presented?

Mr. WALKER. Senator Cochran, I think it is a positive first step. As I mentioned before, I think it exceeded the expectations of many parties as to what it was going to be. I do, however, think there are some important items that are not in the Transformation Plan that need to be addressed. For example, how we are going to go about defining universal postal service in the 21st Century?

Second, what about the infrastructure? How is the infrastructure going to be reviewed and rationalized?

Third, what about comparable wages? What are comparable wages? What about labor flexibility? It is not only a matter of having the right number of people, but it is having the right number of people with the right skills and knowledge in the right place to get the job done, and sometimes that can be a problem.

There are issues like the governance structure. Does the governance structure of the Postal Service make sense now, given the fact that it is, in effect, a Fortune 10 company, the second largest employer in the United States, and yet its governance structure is unusual, I think. For example, there is nobody at the Postal Service at the management level that is appointed by the President and confirmed by the Senate. The Postmaster General is appointed by the Board of Governors, and so, therefore, what does that do to accountability with regard to the American people? Also, the composition of the governance structure, the board itself.

I think there needs to be a look at not only the debt service repayment, which has been mentioned here this morning, but also the issue of the significant retirement obligations. Thirty-two billion dollars for pensions, $49 billion for post retirement health, $81 billion in total, far exceeds the amount that we are talking about for the debt to the U.S. Government. So these are huge sums of money. What is going to be done about these items?

Having an action plan for how are we going to take the good ideas that are in the Plan, what is the vehicle, what is the mechanism, whether it be a commission or otherwise, to try to deal with some of these issues that management cannot do on its own, that it is going to need enabling legislation to be able to address.

Senator COCHRAN. Thank you very much, Mr. Chairman.

Senator AKAKA. Thank you very much, Senator Cochran. Senator Dayton.

Senator DAYTON. Thank you, Mr. Chairman.

General Potter, I hope I can evidence my skepticism and yet still be respectful of the enormity of the task that you have before you and the entity that you are charged with guiding. I think Senator Cochran said it well when he said at the outset that you are a service to this country and need to be recognized as such in a category almost under yourself.

I have trouble with the word "transformation" in the context that you use it because I do not know what it is that you could be transformed to or how you would be transformed given the liabilities that you and the Comptroller General have outlined without going through something that would be almost draconian in its measures. If you were a business today and someone came in and was given the chance to transform you, I could only imagine what it would entail.

But it would seem to me it would be—I mean, $81 billion in unfunded health and pension liabilities and negative productivity over the last decade, and 75 percent of your costs are in labor, as I recall, and your liabilities exceed your assets, certainly you are not going to find many venture capital firms that are going to want to take you on.

The measures that you would have to take to shed yourself of all of those liabilities and impediments would be such, and given, as you say, the constraints, social and the ones that you say Congress imposes, but certainly as an agent for the American people and the expectations established, I do not see how you would begin to be able to undertake those kind of extreme measures. Even if you had public license to do so, where would it get you?

Mr. POTTER. Well, your description of the enormity of the challenge is real. I am not going to sit here and deny that the challenge is not significant. I think that one merely has to look at the numbers, and we could easily draw the conclusion that privatization was not an option. We did not have stockholders, or people, or venture capitalists lining up with dollars in their pockets to buy into this entity.

What we do have, though, is an ongoing concern that meets its obligations. The obligations for health benefits and pensions is one that we have had since 1970 in terms of our transition from a Federal agency to the U.S. Postal Service. By law, we are obligated to provide to our employees Federal pension benefits and Federal health benefits. They are non-negotiable. So you begin with some very basic structural requirements of the Postal Service. By law, we cannot eliminate a post office for economic reasons. So there are constraints within your ability to manage.

In terms of long-term viability, transformation, I believe that the path, given all the constraints, is to be a better Postal Service and to begin to pay down, as best we can, those obligations. Certainly, if we are not successful, the $100 billion burden falls to the Federal Government.

Senator DAYTON. I guess it is my concept of that word that causes me difficulty, because as you say, if we were to eliminate all the legal constraints today and you just had to operate in the real world, most of those constraints would still exist. I mean, you cannot just shed pension and health obligations. You cannot shed

labor costs. You can negotiate and you can go through the disruptions that those kind of, as I say, literally draconian negotiations would entail. You could start shedding areas where you thought it was not advisable or profitable to serve, but you are what you are.

Rather than, at least in my mind, trying to transform yourself into something that you, in a sense, do not want to be, because you said you want to retain the monopoly as the essential element of your operation, it seems to me that you would better serve the public purpose by just identifying how can you be the best at what it is that you are essential to do, which is to deliver regular mail 6 days a week all over the country as efficiently and as cost effectively as possible. If it is not possible to do so within the parameters of the modern realm, those of us who still want to pay our bills by stamp rather than by electronic device, then we are going to have to make adjustments. But I do not see how you can do any better by trying to get into some sort of transformation.

Comptroller General, yes?

Mr. WALKER. If I can, Senator Dayton, I think the word "transformation" may or may not be appropriate to use in this context. If you talk about what is the Postal Service—and part of the definition is, what do you want the Postal Service to be? I mean, part of the answer could be is it should focus more on core and so it should try to do less, but focus on core and do that to the best of its ability. That is part of the debate that I think is intended in the transformation.

The other thing is that there are certain commitments and obligations that you have today that you cannot shed and you would not want to shed. It would not be right to do that. On the other hand, what you can do is to try to end up aggressively managing as much as you can from this point going forward to the extent that you have got the flexibility, the will, and the commitment to do that. We cannot change the past, but I think what we can do, hopefully, is try to see what can happen in order to minimize what that ultimate potential put option would be on the taxpayers, because that is really what you are talking about. There is a put option here on the taxpayers.

Senator DAYTON. And I guess I am much more comfortable with that parameter, Mr. Comptroller General. Where is the freedom within the structural yoke and how can you improve the quality of what it is that you exist to do? We have private enterprises who can do overnight deliveries and send things all over the world and the like. I mean, I do not know whether that is—I would be interested to know whether that aspect of your business is a profitable one for you or not. But that is not why we need you to exist, unless you can do it more efficiently or unless you can generate revenues for other purposes. But we do need you to deliver the mail 6 days a week all over the country, unless we determine as a society that we would rather do it otherwise.

I just think that rather than transforming yourself, just, as you say, improve the quality of what it is that you essentially are there to do and tell us, how can we help you or how can we modify the law that gives you a better ability to do that. I mean, 10 months for the Postal Rate Commission to be deliberating over what your rate should be and when it turns out to be what you proposed it

to be at the beginning, to me, is just absurd. There ought to be ways in which we can help you move more expeditiously and efficiently and do a better job of what you do, and that, to me, would be preferable to trying to figure out how you get yourself transformed into something that you are not going to be.

Mr. POTTER. I think what you just said is exactly what we attempted to do in the document. Transformation was not a Postal term, it was a Senate term.

Senator DAYTON. Well, I was not here then. [Laughter.]

Mr. POTTER. We were requested to provide a Transformation Plan, and we built a plan that gets at exactly what you just said. It attempts to, within the constraints and with the understanding that we are a service, to provide delivery of hard copy mail and provide access to those services for all Americans. We attempted to do that and build a plan that makes for a better Postal Service, one which would even be better and more enhanced if we had some freedoms within the statutory requirements to, again, make decisions about how we meet that obligation.

Senator DAYTON. We all want some form of transformation. I go to the Senate gym and I want to be transformed into this different figure from what I am. [Laughter.]

Senator Stevens, one day he reported his weight. I was avoiding doing that. I did not want anybody even to look or to be able to see the notations, and he gave me good advice. He said, "You just have to set your mind to it and then do it." Well, it involves, as you know, little steps that I would prefer not to take, like eating less and exercising more, but lo and behold, if I just sort of stick with that—I will never be like Mike, but I can get a little bit farther down the road to looking a little more like Senator Carper here. [Laughter.]

I think that realm of the great is the enemy of the good, just get better.

Mr. POTTER. Right. Well, the Postal Service is committed to getting better. We welcomed the opportunity to build a Transformation Plan, but to build a plan that will make us better in the future, better serve the American public, and fulfill our universal service obligation.

I looked at other agencies, because it is a term that has been used by other agencies in the Federal Government, and the difference between us and what other Federal agencies were asked to do was that they were provided a direction. Transform yourself into this. Well, no one has ever defined what the "this" is for the Postal Service, and we attempted to do that with our Transformation Plan.

Suffice it to say, there is more to be done. I do not disagree with the Comptroller General. There is more to be done. We are going to do our best to make it happen and to become a better Service and more financially stable, well into the future.

Senator DAYTON. And there are a lot of ingredients here to do that.

Mr. POTTER. Yes.

Senator DAYTON. Thank you, Mr. Chairman.

Mr. WALKER. Can I say, Mr. Chairman, for the record, I will assume responsibility for use of the term "transformation," and the

reason I say that was because when we put the Postal Service on our high risk list a year ago, we said Postal Service transformation. We did so intentionally, because, obviously, the Postal Service does a lot of things right, and so we did not want to say the Postal Service, as an entity, was high risk. That would not be fair to the dedicated men and women that comprise the Postal Service.

On the other hand, what we were really talking about is what should the Postal Service do, which could be more or less than it is doing now, but it is different than what it is doing now, and how should the Postal Service do business? I would respectfully suggest that no matter what you call it, transformation or whatever, those are the key issues.

I would also respectfully suggest that the Postal Service in many ways is a microcosm of the challenges that many other Federal Government agencies face, and the Federal Government has to change what it does and how it does business, too, and the only difference is with the Postal Service, you have got an income statement and a balance sheet. You touch virtually every American. It is easier to identify with and associate with the Postal Service. As a result maybe we start here first, but there is a lot more work to do on this.

Senator AKAKA. Thank you very much for your question and responses.

Senator Carper, do you have any questions?

Senator CARPER. I sure do. Thank you.

Senator AKAKA. I also need to call on Senator Stevens.

Senator CARPER. Let us go to Senator Stevens first.

Senator AKAKA. Senator Stevens.

Senator STEVENS. Go right ahead.

Senator CARPER. Thank you. Senator Dayton was talking about the gym, going to the gym and working out. We do have options, whether you are Senators or those who are not, with respect to our weight, our physical condition. We can eat more. We can eat less. We can eat different kinds of foods. We can exercise. We can run. We can go to the gym. There are all kinds of different things we can do to enhance our physical health.

In some respects, we do not give that kind of freedom of flexibility to the Postal Service. In your transformation document, you refer to some of those. I have heard the Comptroller General talk about some of them, as well. I would like to focus on those initially, if we could.

Let us talk about pricing—pricing the product that you sell. Just explain to me, just crisply and succinctly, if you will, the process for pricing your services, for raising the cost of First-Class Mail and other kinds of service. Just run through that briefly for me, Mr. Potter, if you will.

Mr. POTTER. It is about a 16-month process. It takes about 4 months for us to assemble the documentation necessary to file a rate case. After that, at the Rate Commission, we go through a 10-month process where we supply testimony; we supply witnesses. There is an opportunity for rebuttal testimony on our part, but there is also an opportunity for any intervenor to provide testimony regarding our rates.

After a 10-month period of time, the Rate Commission recommends rates. It goes to the Board of Governors. The Board of Governors has the option of approving the rates as recommended. They can implement those rates under protest and send them back to the Rate Commission for reevaluation.

And then assume that the Board of Governors adopts the rates as recommended by the Rate Commission. Then we provide customers with a 2-month period, at a minimum, prior to implementation. That allows the more sophisticated customers an opportunity to update their computer systems for the new rate structures, and it gives us an opportunity to get stamps in place so that we can implement the new rates.

All in all, it is approximately a 16-month procedure, and generally, again, because of the timing, you try to predict what your revenue requirements are going to be, in many cases, 2 years-plus out. Given the fact that, for argument's sake, we are a $70 billion industry, a 1 percent swing in terms of our projection, if it is a 3-year projection, that is $210 billion, a $2 billion swing. So it is a very difficult process.

Senator CARPER. How would you like to change that, and then I am going to ask Mr. Walker to critique the proposed changes, if you would.

Mr. POTTER. We have two different, very different, clientele that we serve. One is major mailers, and the major mailers have told us repeatedly for years that they would prefer to have much more predictable rates. They would prefer, for example, that we have annual smaller rate increases versus what ends up today being a 2-year-plus cycle, and they get hit with large increases.

So our desire would be to have phased rates for commercial mailers, and for John Q. Public, individual mailers, we would prefer to have a rate cycle that might be on a 2-year or 3-year basis because people do not like to go and buy a penny stamp, or in this case, a three-cent stamp, to augment what they have, and we would look to do that.

We would also like to have the ability to have market-based rates for non-monopoly products. There are products that, because they are cost-based, we simply do not price as high as we might be able to if we were basing it on market-based rates.

And, last but not least, we would like to have the ability to negotiate prices with individual customers where the customers' mail, the contribution from that mail, what they contribute to overhead, can be enhanced through an agreement. That agreement might have that customer perform work that is beyond what is called for in our current rate offering, whether that is pre-sort or discounts or work share offerings. Where there is an opportunity for the Postal Service to benefit and the customer to benefit, we believe that we should have the flexibility to work out those arrangements and grow the business. As a result of making sure that the contribution was maintained on increased volume, all rate payers would benefit. Those are the main things that we are concerned about.

Senator CARPER. All right, thank you. Mr. Walker.

Mr. WALKER. My comment at the highest level would be that we believe that there is conceptual merit to many of the changes that the Postmaster General is suggesting. We do, however, believe that

you would have to couple it with additional flexibility. Because right now, they basically have a one-size-fits-all approach, and one would debate whether or not that makes sense, especially if it takes an average of 16 months in order to make a rate increase happen when new generations of technology happen every 18 months nowadays.

At the same point in time, if you are going to provide additional flexibility, you have got to have adequate transparency and accountability mechanisms to understand what is being done and to make sure that it makes economic sense and to make sure that there are not unintended consequences happening with regard to other parties.

One other thing that I would suggest is, in many ways, what we are really talking about here is what is universal postal service? What do you want to guarantee that everybody has a right to? For example, that might be everybody has a guaranteed right to receive postal delivery at their location X-number of days a week. That X may not be six. That is something to be decided.

On the other hand, if you want more than that, you can get it. It is your choice, but there is an economic cost associated with that. In many ways, these concepts are concepts that we are going to have to start coming to grips with in other areas where we have big financial imbalances, like health care, where sometimes we try to define a one-size-fits-all and where we have a huge financial imbalance, we are going to have to start talking about, well, what is the minimum? What do you want to guarantee that everybody has? And then are there other choices or options that you might be able to make available to people if they want it and if they think they need it, but there are some economics, whether it be on the—different forms of customers, if you will, I think, to be able to deal with it.

Senator CARPER. Mr. Walker, earlier in your comments, I think you said that the U.S. Postal Service model as it exists today is not a working model, not a workable model for the 21st Century. My recollection is Senator Stevens was present at the creation of the model that has worked now for over three decades and deserves a lot of credit for the leadership, time, and energy that he put into its creation.

If this is not a workable model, if the current model is not workable in the 21st Century, what major changes do we need to make so that it does become a workable model?

Mr. WALKER. Well, I think that——

Senator CARPER. You talked about some of them with respect to pricing flexibility. What are some others?

Mr. WALKER. Right, and there are many outlined in my testimony, but I think the bottom line is that while what was done in 1970 under Senator Stevens' leadership and others obviously made sense at the time, the world is a fundamentally different place in 2002 than it was in 1970 in so many different ways. What is more important is not what it is today or what it was in 1970, but how rapidly it is changing and what forces are we experiencing today and are we likely to experience looking forward. I think if you look at all of those factors, the numbers just do not add up. It just will not work.

And so I think you need to do a number of the things that the Postmaster General has talked about within the context of current law and you need to address the elements that I talked about that are not in the Transformation Plan and we need to figure out what is a mechanism, be it a commission or whatever else, to try to start dealing with some of these difficult questions to make some recommendation to the elected officials who represent the American public so that they can make informed judgments about what makes sense looking forward.

Senator CARPER. General Potter, your thoughts with respect to Mr. Walker's assertion that the Postal Service as it exists today is not a workable model in the 21st Century?

Mr. POTTER. Well, I believe that the challenges that face the Postal Service require change, and I think we outlined a significant amount of change that we can make internally today that certainly should be available to the Postal Service, particularly in terms of defining its infrastructure. We should have the most efficient infrastructure possible that serves the American public.

Regarding the long-term model, again, as I said earlier today, the challenge to a monopoly product, First-Class Mail, and the risk that we have in terms of diversion of that product make the business model that we have today, under the current definition of universal service, one that will not have the Postal Service sustain itself long into the future. We do need to change to meet the challenges that face us.

Senator CARPER. Mr. Chairman, my time has expired. If there is a second round, I would welcome the opportunity to ask a couple more questions. Thank you.

Senator AKAKA. Thank you for your questions and the responses. Senator Stevens.

Senator STEVENS. Thank you, Mr. Chairman.

It appears to me, or maybe I should say it sounds to me like some people are suggesting more Congressional involvement in the Postal Service. I hope that is not the case, because I remember too well the time when we appointed the postmasters in every little town in our States. If nothing else, we had one friend and 12 enemies because everyone wanted to be postmaster.

But from my point of view, it seems to me we are premature in transitioning into the perfect model for this century because there is a generational problem. I was told the other day that when the baby boomers retire, that generation will be the first generation that is really computer literate and we are going to go into a different mode, I think, in terms of mail and in terms of personal mail sometime around 2015, according to the projection I saw.

But let me go back and ask this question. It is my memory that a lot of this debt that we are talking about today really comes out of the old Post Office Department. Has that debt ever been totally eliminated? I think you are still carrying forward enormous debt, are you not, from the Post Office Department?

Mr. POTTER. Well, we are carrying a liability for retirees, some of whom worked under the old Post Office Department, so in that regard, yes, we do have some liability that is carried over.

Senator STEVENS. Another difficulty I have with the Postal Service, looking at transformation or transition, whatever you want to

call it, is that in most of the rural areas, the package delivery services reach a certain point and then they drop them in the mail. Most people do not understand that. These ubiquitous services are in the urban areas. When they get to rural America, they just end up mailing the packages. If there is to be a total universal service delivery of packages, the Postal Service has to be maintained in the rural areas more than in the urban areas, would you agree with that?

Mr. POTTER. I would say that our ability even to provide affordable package services in rural areas is dependent upon a national network of packages that provides the revenues necessary to maintain that network.

Senator STEVENS. And it is the revenue base from the short-distance delivery that gives you the ability to maintain the long-distance, out to Unalakleet and Chignik and up into the mountains of Tennessee or Kentucky, is that not right?

Mr. POTTER. That is right. The short-term delivery, we make money on that, and that helps us with the greater cost for some of the more remote deliveries that we provide.

Senator STEVENS. And as we look at the First-Class Mail, one of the significant differences in delivery of First-Class Mail is the protection for the U.S. Postal Service for the mailboxes, right?

Mr. POTTER. Right.

Senator STEVENS. None of these other businesses maintains the security services you have to assure the privacy of mailboxes.

Mr. POTTER. Right. We have the Postal Inspection Service, some 2,000 people strong, that maintain the sanctity of the mailbox. Only a mail carrier can place or has access to a mailbox around America.

Senator STEVENS. And all you have to do is pick up a Sunday paper to realize how much that means, because if it were not for the privacy of that mailbox, all that stuff you get in your Sunday paper would be in your mailbox every day.

Mr. POTTER. Well, that would not bother me. I would like the revenue from that. [Laughter.]

Senator STEVENS. I question, really, the timeliness of really making decisions for a long-term future right now in terms of a transformation process. I still think we ought to be going for another interim period. The Postal Reform Act of 1970 really provided one interim period. It has lasted longer than we thought it would, really, 30 years, 32 years. It does seem to me we ought to have an interim date in time and head for the time when more and more of the people involved are, in fact, using E-mail or digital mail and look at what the system is going to be sometime between 2015 and 2020 and look out not much further than that, because I think technology is tumbling so fast now, we do not know what is going to happen.

The only thing I do believe is that no matter what we do now, if rural America is going to survive, it has to have the package delivery service. How much of your business really is associated with packages now?

Mr. POTTER. It is probably on the order of about 6 to 7 percent of our business in terms of revenue. It is much smaller in terms of volume.

Senator STEVENS. How about in terms of cost?

Mr. POTTER. In terms of cost, it is about the same. But we are the sole provider of package services to many addresses in America, and so it is vitally important to those communities that the Postal Service maintain its presence in the package market.

Senator STEVENS. Precisely. And now we have the Social Security Administration and the IRS making it easy to deal with them totally online. That affects your revenue base, does it not?

Mr. POTTER. It certainly does, and we have seen a dramatic decline in revenue right here in Washington, DC, as a result of the Federal Government's efforts to move mail transactions to electronic medium.

Senator STEVENS. Let me get really provincial, because I think we are going to ask the Committee to mark up a bill here this month that deals with what we call the bypass mail system of Alaska. For your information, gentlemen, after the Airline Deregulation Act, we provided an essential air service concept for areas that had received air service and guaranteed they would receive at least 3-days-a-week service, and that was related to the mails, really, because mail was delivered in those small planes.

We then in Alaska found that one of the great problems was that some of the planes were capable of carrying packages, large amounts of packages, and some were not, so we devised what we call a bypass mail system. It literally bypassed the Postal Service, made up into pallets to the size of the carrier involved. That has gotten into a very difficult situation now with too many small planes and the cost has increased for the Postal Service. I understand the Postal Service expects to lose this year in excess of $100 million in Alaska——

Mr. POTTER. Yes.

Senator STEVENS [continuing]. And we are trying to counter that. Are you aware of the bill that Congressman Young and I have introduced to try and fix this system so we will still maintain the bypass mail system and reduce the cost to the Postal Service?

Mr. POTTER. I am very aware of that legislation, and the Postal Service supports the passage of that legislation. We think it is vital to two things, one, providing a high level of service and, two, providing economic relief in the sense that it will lower our cost to provide that service. So we are very much in support of that legislation.

Senator STEVENS. It is controversial up my way because it would prohibit further entry into that system as long as there were a sufficient number of planes available to you to handle the mail as it exists now unless new carriers want to provide passenger service, and it has become controversial, so the members will hear more later, but I appreciate your comment on it.

My last comment would be this. If you look at the system now in terms of cost effectiveness, would you rather have the Post Office Department or the USPS?

Mr. POTTER. I would much rather have the U.S. Postal Service. I think we have done a phenomenal job in terms of moving the mail effectively. As a matter of fact, I asked some people to go back and look at our statistics. Today, we have the same number of people in the Postal Service as we had in 1991. But since 1991, the

number of possible deliveries we have, the number of households and businesses that we serve, has gone up 15.4 million. So every day, 6 days a week, we are at 15.4 million additional doors than we were in 1991, and we have some 33 billion more pieces of mail.

So we have managed to grow as America has grown, and we have done that, in my opinion, in an efficient way. I know Senator Dayton referred to some data regarding productivity, and I think we can have a debate about what model one might use to determine productivity. But the fact of the matter is the Postal Service has met the demands of the American public in terms of new households and the growing volume in our system, and we have done that more efficiently and our people are doing an outstanding job.

Senator STEVENS. One last question. Mr. Walker, are you suggesting more Congressional involvement in management of the Postal Service?

Mr. WALKER. Senator, no, I am not suggesting that. What I am suggesting is, just as you noted, in 1970, where there was a need to go to a new model and that the Congress had a role to play in order to enact legislation that would enable that to happen, that we are now at the point today where in order for the Postal Service to try to address a number of these challenges, there is going to need to be legislation in order to position it for the future.

You are correct in saying that a lot of things about this country are going to change in about 2015 because of the beginning of the retirement of the baby boom generation and we need to recognize that and we need to assess what changes need to be made in light of that fact, not just with regard to the Postal Service, but our fiscal condition, among other things.

But I do think Congress is going to have to do something similar to what it did in 1970. Namely, to step back and say, all right, this is not working. What do we need to do going forward and what type of legislation is necessary in order to enable the Postal Service to do the best that it can for the next 10 or 20 years without micromanaging.

Senator STEVENS. But you said something about not having a presidentially-appointed Postmaster. Do you think that is advisable?

Mr. WALKER. I think that you just need to think if from the standpoint that the only persons that are directly accountable to the Congress with regard to access issues and testimony historically have been presidential appointees or PASs. Fortunately, you have not had a problem with Postmaster General Potter. He has been kind to come up here any time you have asked him. I think that is appropriate, given his role and responsibility.

But the only presidential appointees that you have with regard to the Postal Service is the Board of Governors and they are all part-time employees. I think you need to think about, given the challenges that the Postal Service has, do you think that is adequate for accountability to the Congress and the public? That is your call.

Senator STEVENS. My call would be the same as it was in 1970—— [Laughter.]

Mr. WALKER. And——

Senator STEVENS [continuing]. And that is to keep it as far away from Congress as possible——

Mr. WALKER. I hear you. [Laughter.]

Senator STEVENS [continuing]. On a day-to-day basis and to get professionals in the Postal Service and use the Board of Governors as really overseers of those professionals and to assure the professional capability.

The Postmaster General is happy to come up here once in a while because every once in a while, we do give him a little bit of money.

Mr. POTTER. True, and we appreciate that. [Laughter.]

Senator STEVENS. We just went through that period, and without it, they would not have survived. So I think that there is always the connection of ultimately stepping in with Federal money. I think we ought to step in with Federal money to try to slowly retire some of that debt, too. That is eventually going to be our burden. We would be better off to attack it on the basis of a few hundred million a year than to sometime have to swallow $8 or $9 billion, and I really think we should do that.

But I thank you very much for your comments. I personally believe that this system has evolved better than any of us dreamed it could at the time, because the Post Office Department was a mess and I do not think that the Postal Service is a mess now. So we need to try to improve it, but Senator Hollings tells me, "Don't fix it if it ain't broke," and I do not think the Postal Service is broken.

Mr. WALKER. Senator, I would totally agree with you that you do not want Congress involved in ongoing operations of the Postal Service or, frankly, any other entity. I mean, the Congress should not be micromanaging any enterprise, if you will. You do need professional management.

I do think you should look at the Board of Governors and make sure that you are comfortable with how that is working. Clearly, the Board of Governors, I would argue, if it is similar to a board of directors, you are expecting those individuals to be very knowledgeable about the activities of an enterprise of this size and magnitude and scope and that they should be the ones, in many ways, in the vanguard, talking about some of these difficult issues and bringing them to the attention of the Congress and trying to make sure that management is doing what it can, but to the extent that it cannot and it needs legislation, they should be here talking about that, as well. I think that is part of the governance structure.

Senator STEVENS. Thank you very much, Mr. Chairman.

Senator AKAKA. Thank you very much, Senator Stevens, for your historical perspectives and solutions that you bring to the Subcommittee.

Let me begin the next round with a question for Mr. Potter. Mr. Postmaster General, I was pleased that the Plan highlights the longstanding human capital and labor issues facing the Service. According to the Plan, "Challenges in this area include workforce planning and complementary adjustments within the constraints of current labor agreements." Would you explain why the Plan focused solely on the Railway Labor Act and whether other options

have been discussed now that you have met with the union representatives.

Mr. POTTER. We have begun a process of working with our union leadership to address some of our concerns about the collective bargaining process and the dispute resolution processes that we have. I am very happy with the nature of those interactions. I think that management has built trust with our unions and management associations, and that trust, believe it or not, started with the anthrax incident. I mean, we have been working right along together for a number of years, but I think that crisis solidified our relationship, because early on, we brought the leadership, the union leadership, and management association leadership, together to discuss what was going on with anthrax. We made them part of our day-to-day management meetings regarding that topic.

We followed that same model with the recent mailbox pipe bombs, brought them in early, communicated to everybody. In my mind, the key to the future is communication.

What we are attempting to do with our discussion of the Railway Labor Act is to highlight the problems that we have with the current arbitration model. That model, that collective bargaining process model that we have today, has both parties come to a table and state public positions that are very much apart. Management might say that the employees deserve no raise. The employees could say, give us 10 percent per year. And then, from a public standpoint, we retain those positions because of the fact that, ultimately, we might end up in front of an arbitrator. So neither party wants to state publicly as to what their positions are.

In the meantime, in the back room, we manage to narrow those differences, and then, if we are lucky and if things work out, we reach agreements. Recently, we just reached an agreement with the National Association of Letter Carriers on a 5-year deal. We have had successful negotiations. But if we do not reach a negotiated agreement, we go to optional fact finding, where again the parties go back to stating diametrically opposed positions to posture themselves for arbitration. We might narrow the difference in fact finding or optional mediation, and then we move into arbitration, where again, publicly, we have significant differences, just to narrow them again and then have an arbitrator make a decision.

Well, our proposal, and what we think the benefits of the Railway Labor Act would be, is that it would have us use a mediator to narrow our differences and push the parties toward settlement. Both parties would not have the easy out that they do today with an arbitrator.

Now, we have also had discussions with the unions about a process called med-arb, where after negotiations, if they are not successful, we move into mediation that would then carry through into arbitration. So if the positions are narrowed, the arbitrator's decision would be on a narrow range of topics as opposed to a very broad range of topics.

We are going to continue to have discussions with our unions on this matter. Our goal would be to reach agreement with them, and should we reach agreement, then that would very much change our position regarding what ultimately would need to be legislated.

So we are working every track we can. Short-term, we are trying to work with the parties that might be impacted by the changes that would affect them throughout the Transformation Plan. We are working again with you and the Congress on some short-term, less complex legislation that would give us a few tools, and then long-term, on the more complex legislative reform that we think would enhance the Postal Service's ability to provide for its universal service obligation.

Senator AKAKA. Do you have any further comments, Comptroller General?

Mr. WALKER. Yes, I do, Mr. Chairman. I think there is merit to the idea of trying to narrow the number of issues that might go for binding arbitration. Obviously, to the extent the parties can agree through the normal collective bargaining process, that is desirable, but mediation, the possible use of mediation before you get to the point of arbitration, I think is something that should be given serious consideration.

There are some important issues here that have to be focused on that in my opinion have not been focused on adequately in the past under the current system. First, what is competitive compensation? On what basis are you trying to determine what comparable wages are, and by the way, you just cannot go by wages. You have got to consider total benefits, including pension benefits, retiree health benefits, and a variety of other benefits. On what basis is there an attempt to try to understand what is competitive compensation and how is that cranked into the process right now. I do not think it is adequate right now.

Second, what about labor flexibility? To what extent is there a need to try to create some additional flexibility with regard to utilization of the existing employees?

Third, what about management? On the other side, what about management compensation arrangements? On what basis should management be paid bonuses and what type of productivity increases should be rewarded? Do they really increase capacity where it is needed? Do they really decrease cost?

So I think there are a number of issues that have to be focused on here that I think the current system has not allowed it to be focused on adequately and some changes may be appropriate.

Senator AKAKA. Mr. Potter.

Mr. POTTER. If I could just add to that, regarding comparability to the private sector in terms of wages, comparability is an issue that has been the subject of many arbitrations over our 32-year history. Today, that is defined through arbitral history as opposed to being defined more narrowly by the legislation that guides us. So that is a term that obviously is subject to interpretation, and today, the interpretation is that of the third-party arbitrator that guides the outcome of our negotiations/arbitration.

Senator AKAKA. Mr. Walker, do you have any comments on the appropriateness of the Railway Labor Act for the Postal Service Act?

Mr. WALKER. Well, as I mentioned, Mr. Chairman, I think that the current process has resulted in some challenges, most notably in the area of comparable wages. I mean, in effect, the arbitrator

is trying to decide that without having some type of real foundation or definition as to what should be looked at.

Before I became Comptroller General, among other things, other than being a CPA, I ran the global practice for a major firm in the human capital area and I dealt with executive compensation strategies and pension and health care. These are issues that are not novel concepts, and yet it does not seem to me that they have been adequately addressed, and you are talking about significant sums of money. Seventy-plus percent of the cost of the Postal Service deals with people costs.

So I think that there are some issues that have to be looked at under the current act, including whether or not some definitional guidance ought to be provided in a few areas.

Senator AKAKA. Mr. Potter, the Transformation Plan suggests that the Postal Service, in finding new ways to reduce costs, may want to have more control over the investment of its retirement fund assets. Does the Service want to establish a new single employer plan covering Postal workers, and if so, would it want to take over CSRS or FERS? Who would make the investment decisions and who would bear the risk?

Mr. POTTER. Today, our banker is the Treasury, and what we would propose is that the monies that are collected from our employees in terms of their contributions to retirement be put to work. So, the risk would be borne by us, that is, the Federal Government, but we think that there are vehicles there that would enable those funds to be put to work to help contribute to the costs of providing those benefits.

Senator AKAKA. Thank you. I will yield to Senator Cochran.

Senator COCHRAN. Mr. Chairman, just a couple more questions.

On the issue of debt reduction, Senator Stevens made a point that I thought we need to think about some. You have come to the realization that there are only two ways that you can generate revenue to apply to debt reduction, cut costs or raise revenues, or a combination of both. Then there is the option that Senator Stevens suggested and that is direct appropriation by Congress to apply to debt reduction. What is your reaction to that? I will ask the Comptroller General first, and then the Postmaster General.

Mr. WALKER. Obviously, there are a variety of parties that would like for the Federal Government to assume directly certain existing obligations, whether it be debt service or whether it be unfunded pension or health liabilities. When Congress created the Postal Service, the idea was it was supposed to be a self-sustaining entity. I mean, these types of obligations normally would have to be borne by an employer and they would be expected to be able to cover them in their cost.

But, obviously, the Postal Service is a hybrid entity. I mean, it is, on one hand, a commercial enterprise, on the other hand, part of the social fabric of our Nation, and it is also part of the U.S. Government. So I think that is something that, frankly, only elected officials can decide. I would not want to have a recommendation on that.

Let me just put it this way. Senator Stevens mentioned that a lot of things are going to change in this country starting in about 2015, and I agree with that. One of the things that the long-range

budget simulations that GAO has done shows is that we are going to have serious fiscal problems starting at about that point in time due to known demographic trends and rising health care costs. So even if the Federal Government was to decide that it wanted to assume part of these obligations, it has got its own problem in figuring out how it is going to be able to deliver on its promises, given some of the simulations that GAO has done. So I think we need to be thinking about making sure that the U.S. Government can deliver on its promises, too.

Senator COCHRAN. Mr. Potter.

Mr. POTTER. The health benefit and pension liabilities that we are discussing have been built up over a 32-year history of the Postal Service. The Postal Service has in its annual reports provided information on both of those matters. In fact, from a transparency standpoint, every 4 weeks, we publish our financial and operating statements. So it is not a surprise to me, and I do not think it should be a surprise to anyone, that those obligations have grown over the years.

Certainly, one option that is available to the Congress is to help fund that. Now, we have not asked for that help, but when funding that obligation, there are two alternatives, or three alternatives. It is borne by the ratepayer, Congress helps, and/or we find ways of becoming more efficient or redefining our obligations within statutory requirements that will allow us to generate the funds necessary to pay down that obligation. I think that all three need to be considered.

Senator COCHRAN. One thing about deficit reduction is that there is nothing in the Transformation Plan that looks like a deficit reduction plan. Did we miss something, or is there a proposal by the Service for debt reduction or revitalization of your capital program?

Mr. POTTER. Obviously, there is a process today to pay down our debt, the some $12 billion that we may have by the end of this fiscal year. It is built into the rate process. It is prior year loss recovery.

Today, there is no vehicle to consider the health benefit liabilities or the retirement obligations as part of the rate-setting process. So the vehicles that are available to us today are basically to cut our costs, and we have a narrow window where that cost cutting can be used to pay down. First, we pay down our debt, and then we would be able to address those liabilities. So today, there is no mechanism that I am aware of beyond paying down our debt, the $12 billion that we referred to, to deal with those long-term liabilities, and that is certainly an issue that we have to wrestle with. I do not disagree that there is a need to address that problem.

Senator COCHRAN. This weekend when I was home, one of my constituents came up to me at a commencement exercise where I was speaking, a graduation class at a college, and said, "Be careful what you approve that is being recommended for transforming the Postal Service," and I got the impression this person was a local Postal manager, maybe a postmaster, although I did not really have an opportunity to explore the details of what the concerns were.

Now that I am here today and I look at some of the suggestions, one is that there be performance-based compensation, and I

thought, whoops, maybe that is it. Maybe that is what I was running into there on the ground, that they have heard about this. Should Postal managers be held accountable in some way for the declines in the financial or service performance of the Postal Service?

Mr. POTTER. I do not believe that they should, but I do think that they should have incentives and be held accountable for improving the Postal Service and for the level of efficiency that their operations have, for the level of service that they provide to the American public, and for the way they treat employees. And certainly, there is a need for accountability.

There is a need to have a performance, customer-focused culture, and we are moving ahead to change that culture and to make sure that people understand what is expected of them and that we hold them to those expectations, making sure, though, that we provide them the tools to be successful. You can create expectations, but if you do not provide people the mechanism and the tools to achieve those expectations, then it is not a fair system. What we are talking about is building a fair system that recognizes and rewards people's successes.

Senator COCHRAN. Mr. Walker.

Mr. WALKER. Senator, I would say that any type of enterprise, whether you are in the government, the private sector, the not-for-profit sector, needs to have a system that provides incentives for people to do the right thing, adequate transparency to provide reasonable assurance the right thing is done, and appropriate accountability to make sure that the right thing is done.

In that regard, in looking at compensation arrangements, typically, most state-of-the-art enterprises are focusing on a balanced scorecard model where you end up saying, I want to see what type of results or positive outcomes have been achieved based upon predetermined measures at the beginning of the year. I want to know what your customers think of you and I want to know what your employees think of you. It is a combination of those three things that end up giving you a better picture to properly be able to recognize and reward people that need to be and to deal with people who have to be dealt with.

Senator COCHRAN. Thank you very much. Thank you, Mr. Chairman.

Senator AKAKA. Thank you very much, Senator Cochran. Senator Carper.

Senator CARPER. Thank you, Mr. Chairman.

Earlier in my first round of questioning, I was trying to explore with both of you some things that we might be doing differently as a Congress in order to help you right the financial ship of state of the Postal Service. We talked about pricing flexibility, and I appreciate the comments of both of you in that regard.

Earlier in your testimony, Mr. Potter, I think you spoke of productivity and I think you looked back through the first 6 or 7 months of this fiscal year and indicated that productivity, while it dipped a bit in the earlier part of the year, was, year-to-date, up by a small margin. I do not follow very closely productivity for our economy as a whole, but I think if you look at productivity in the most recent quarter, productivity was up by about 8 percent, and

I think that is an aberration, but it is certainly strong performance. I think productivity in the fourth quarter of calendar year 2001 was up somewhere between 2 and 3 percent, which is probably a little closer to the mark.

The point I am getting to is productivity at the Postal Service, long before you became Postmaster General, has tended to lag that of the rest of the economy. I am sure a lot of trees have been killed printing reports on why the productivity is not better in the Postal Service. I just ask you today, what can we do as a legislative body with the President to enable you to capture some real gains in productivity? It is pretty clear that that is one of the things that has to be done. What do we need to do? What do we need to do to enable you and your employees to be more productive?

Mr. POTTER. I think the one thing that stands out in my mind is to provide us the ability to change our infrastructure. I think when Senator Cochran talked about talking to a constituent back home, it could have been anybody. I think that when you think about change, people tend to resist change. Certainly, we have opportunities——

Senator CARPER. Certainly never in the Senate. [Laughter.]

Mr. POTTER. We have the opportunity to reconfigure our networks, our networks of processing plants, our network of post offices, stations, and branches; to reconfigure those buildings that we have, those processing operations that we have that we can become more efficient, so that we can drive service levels even higher than they are today. But there is a resistance and a reluctance on the part of people to support that change.

When I look at where we are today, and the one thing that I think we can do to really impact the bottom line in the short term, it is the changes that are necessary in our infrastructure that will allow us to reduce the nodes on our network. With fewer nodes to serve, there is less transportation and greater convenience to customers. There are a lot of major customers that bring mail to us. There is a lot of opportunity there, in my mind. And that is the one area that I think we need to embark on, and embark on rather quickly, if we are to be successful.

Senator CARPER. In the Carper family, for the most part, the husband does the grocery shopping, and I was out grocery shopping this weekend and I noticed in one part of the supermarket, this regular old supermarket, they have the bread and the deli and the butcher shop and all, and in one part of the supermarket, they had a bank and a couple people actually working there over the weekend in the bank.

I used to be a Congressman for about 10 years and then I was Governor for 8 years and I have been here for about the last year and half with these fellows, and I have never had anybody come to me in Delaware and say, boy, we would like for you to close our post office. I am still waiting for the first person. [Laughter.]

I have a lot of people who say, we would like to see a new one built, or we sure would like to see you intercede and not have a post office closed in our community. I have never had anybody come and say, close our post office. What is it going to take to get people to say, I was not crazy about closing that post office, but by golly, we can go down to the supermarket and get better service—

much better service, more extended hours than we ever could in the old regime.

Mr. POTTER. I think it is a function of knowledge. If one thinks about the network of post offices that we have today and we had some 28,000 or 29,000 post offices in 1970, we pretty much have that same network of post offices. In addition to that, we have stations and branches in our larger cities.

Since that time, though, people's access to postal services has changed dramatically because most people now buy stamps in supermarkets. That supermarket that you were in with the bank, if you had gone to the checkout counter and said, "Can I have a book of stamps?" you would have been provided a book of stamps for a fee. That access did not exist 32 years ago. So we have stamps on consignment at over 40,000 locations throughout America, in supermarkets and the like. We have 4,400 contract post office units. We have stamps by mail. That is a very convenient way to access postal services, stamps on line. You can now buy postage over the Internet.

So I think that there is a need to reevaluate on everybody's part what services they can access, how much more convenient the Postal Service has made things, and how much more convenient things could become if the Postal Service had certain latitudes when it comes to brick and mortar.

I was in Evansville, Indiana, not too long ago, and I went down to the downtown area to this beautiful post office building, a really nice historic building. Unfortunately, that whole area was surrounded by businesses that had been shuttered because Wal–Mart moved to a strip mall on the outskirts of town and with it went all the businesses. So the convenience that the people in that location had in terms of accessing the postal services as a part of doing their normal day-to-day business was lost because they were out at the strip mall in the new business center, retail business center, and the Postal Service was in a downtown location in the old business center. Now, it is great for us to be there. We are ready for the revival of the downtown area 20 to 50 years from now, but I do not think that that is a good business model.

Senator CARPER. Mr. Walker.

Mr. WALKER. Senator, I think this is critically important. There is a difference between points of service, which I would assert we ought to have a lot more of, and we do have a lot more of than we did in 1970. It could be at a grocery store, it could be at a bank. There are a lot of different places you can have where you have points of service other than the traditional post office, if you will, online, etc.

We have got to maximize points of service in an economical fashion. We ought to minimize bricks and mortar. We have too much bricks and mortar. To the extent that we have bricks and mortar, we ought to maximize utilization of that bricks and mortar from an economic standpoint.

The fact is, in the current situation, the one that Postmaster General Potter just mentioned, what happens is that the post office ends up opening up a new facility where the new business is, to the extent that it has got the capital to be able to do that, but it does not do anything about the facility that use to be viable and

is no longer viable because it cannot close post offices based upon economic performance. What happens, then, is that you end up driving your cost up, you end up driving your productivity down, and then you have got asset recovery values that are hanging out there, as well, and these are on a huge scale.

So I think it is something that is critically important and that Congress will have to end up authorizing in order for something to be done in this area, because right now, they are constrained. They just cannot do it.

Senator CARPER. Let me change gears and return to something I mentioned during my first round. It is the idea of using the revenue from first class service, over which the Postal Service has a monopoly, to cover expenses for services that are competitive. I said, General Potter, my recollection is about half your volume is First-Class Mail, but my understanding is that First-Class Mail covers about two-thirds of the Postal Service's institutional costs. If that is wrong, please correct me.

Over in the House, I met with a fellow named Congressman McHugh, who has been working on these issues for a long time, and I like to say that in the Congress, you have to be really good at deferring gratification. He must be very good at deferring gratification because he has been working and working at this for a long time. I am not sure I am that good.

But I understand that he has drafted some legislation that would separate competitive and non-competitive products so that each of the competitive products would pay for its share of institutional costs. Do I have that right? I would be interested in your comments and those of Mr. Walker, please.

Mr. POTTER. There is a misperception that there is cross-subsidization of products, and I think that is where we are headed. Right now, it is illegal for the Postal Service to cross-subsidize one product with another. The Postal Rate Commission is charged with assuring that we obey the law in terms of our rate setting. Now, there are opportunities for us to take advantage and customers to take advantage of our economies of scale and scope when it comes to other products.

The legislation that you are referring to would, again, not allow cross-subsidization—it is not allowed today—but it would give the Postal Service more freedom on the competitive side in terms of pricing flexibility. It does not—today. The premise that those products do not pay their share of costs is not accurate. So I would have concerns with the premise on which you base that question.

Mr. WALKER. I have not seen the latest piece of legislation, so let me just say that I think that some additional degree of flexibility, pricing flexibility, as I mentioned before, I think makes sense, coupled with additional transparency and accountability.

Second, I think that part of it is, how do you define what cost is? As I mentioned in my opening statement, right now, we have got significant retiree health obligations, we have got significant pension obligations. How are they being accounted for? What about existing infrastructure costs? How are they being accounted for and how are those costs being allocated in determining what the appropriate rates are? I think there are some real issues there that involve lots of money.

Senator CARPER. Mr. Chairman, my time is expired. If there is another round, I would be pleased to ask another question or two.

Senator COCHRAN. We are out of rounds. [Laughter.]

Senator CARPER. I thought we might be. Can I just mention one last quick point?

Senator AKAKA. Go ahead.

Senator CARPER. This sort of relates to productivity, but the issue is workplace safety. I understand there is a fair amount of Workers' Compensation costs that are borne by the Postal Service. I think we have actually talked a little bit about this before. I know I have talked with the Chairman of the Board of Governors about it. Workplace safety, how are you proposing in the transformation document to enhance workplace safety and just try to reduce the very substantial costs that you have there?

Mr. POTTER. Let me make a couple of points. The Postal Service has about half of the Workers' Compensation claims that the Federal Government has, but we have about one-third of the costs of that program. We manage safety very aggressively. As you are probably aware, we came under OSHA guidelines for private companies recently. We are working very hard, and we are having some good success at bringing our accident rates down.

This year, Workers' Compensation is a particular problem because our accident rates are down, yet our Workers' Compensation costs this year are going to be some $500 million greater than planned. Much of that is driven by some actuarial changes, as well as the rising costs of health care and costs of the procedures that we have for those people who are on OWCP.

The key, in my mind, the first step when it comes to Workers' Compensation, is to have a safe work environment. That is our No. 1 priority when it comes to addressing Workers' Compensation costs today and into the future. We are making some good progress regarding the safety record in the Postal Service.

Mr. WALKER. Just very quickly, Senator, we at GAO believe that there are some issues with regard to Workers' Compensation that need to be looked at, and if GAO can be of any assistance in trying to do any analysis here, we would be happy to do that.

Senator CARPER. Mr. Chairman, thank you for giving me a little extra time here.

Senator AKAKA. Thank you for your questions.

Senator CARPER. Thank you, and to our witnesses, thank you for being here.

Senator AKAKA. I have many more questions to ask you. However, as tempted as we are to continue, we must call this hearing to an end. But let me ask a follow-up question to Senator Carper's, since you raised it, Mr. Walker, and this is to Mr. Potter and Mr. Walker. Do you believe a base closing commission would be helpful to deal with facility closing and consolidations?

Senator COCHRAN. Like the military has.

Mr. POTTER. Well, I think an effort to address the infrastructure of the Postal Service is necessary. I believe that with the Postal Service in a position to outline the opportunities and make a business case for why we should change the current infrastructure, and while we would prefer to have a change in the legislation that would give us some more freedoms, certainly anything that moves

in the direction of looking at this situation and, again, providing guidance to the Postal Service, would be welcome.

Senator AKAKA. Mr. Walker.

Mr. WALKER. I think given the real political realities, you are going to need to consider something like a Base Realignment and Closure Process or BRAC. Obviously, you would expect that Postal management would come forward and make recommendations. Obviously, you would expect that other stakeholders, the employees, customers, and a variety of others would come forward and make their case. But in the end, nobody likes to close anything and change is difficult. So, therefore, I think from a practical standpoint, in order to be able to look at this in a comprehensive fashion rather than a piecemeal fashion, you are going to need to consider something like that, I think, in order to make it a reality.

Senator AKAKA. I thank you very much, Postmaster General and Comptroller General, for being with us today. Your testimonies and responses to our questions have been valuable to our review of the U.S. Postal Service.

This hearing will not be the last that we will hold on a plan, I am sure. It was, however, as you mentioned, a good first step towards a Transformation Plan.

I want to commend the Postmaster General and the Chairman of the Postal Rate Commission for taking the next step, which is convening an open summit on May 28 to discuss potential changes to the omnibus rate making process.

Senator Cochran, do you have anything else to add?

Senator COCHRAN. Nothing further, Mr. Chairman. Thank you.

Senator AKAKA. I want to thank everyone for joining us today. All that you have done will be helpful to our cause. Thank you very much.

This heating stands adjourned.

[Whereupon, at 12:15 p.m., the Subcommittee was adjourned.]

APPENDIX

UNITED STATES
POSTAL SERVICE

STATEMENT OF
JOHN E. POTTER,
POSTMASTER GENERAL/CEO,
UNITED STATES POSTAL SERVICE
BEFORE THE
SUBCOMMITTEE ON INTERNATIONAL AFFAIRS,
PROLIFERATION AND FEDERAL SERVICES
OF THE
COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE
MAY 13, 2002

Good morning, Mr. Chairman and members of the Subcommittee.

I welcome the opportunity to speak with you today about the transformation of the United States Postal Service. It was only one year ago that the Committee on Governmental Affairs conducted a hearing to review the condition and prospects of the Postal Service in a radically changed competitive, technological and economic environment.

Describing the condition of the Postal Service at that hearing, Chairman Fred Thompson said, "The ox is in the ditch – big time!" His sentiments were echoed by the Comptroller General of the United States, David Walker, who placed the Postal Service's transformation efforts and long-term outlook on the GAO's "high-risk" list because of our significant financial, human capital and structural challenges.

In the year since that hearing, the Postal Service's long-term financial outlook has grown even more cloudy. The 2002 economic downturn hit us hard – and continues to hurt us. On the heels of the recession came 9/11, then the anthrax bioterrorism attack. By the end of fiscal year 2002, we expect mail volume to be down by six billion pieces, the most significant decline in more than 70 years. It will contribute to a projected net loss in the range of $1.5 billion this year – for a third consecutive year of net losses.

As the Comptroller General said, "The Service's ability to provide universal postal service as we know it today will be increasingly threatened unless changes are made, both within current law and to the legal and regulatory framework that governs the Service." It's clear the business model set up in 1970 by the Postal Reorganization Act was devised for another time. This model needs to be addressed – the sooner, the better.

Despite the impact of the recession and the terrorist attacks, we have taken steps to reduce costs and to manage the business more aggressively than ever before. By the end of this year, we will have reduced the number of career employees by 20,000. We will do that through attrition. We will also have reduced workhours by over 60 million compared to last year. And we are postponing other program expenditures and delaying capital investments.

Even with these short-term actions, we recognize the critical need for a long-term approach to the issues the Postal Service is facing. This was the consensus following last year's hearing and it resulted in the Postal Service's creation of a comprehensive Transformation Plan. We delivered that Plan to Congress one month ago.

We believe the Plan offers the flexibility to give the Postal Service the long-term tools it needs to carry out its universal service mandate. That mandate represents a public policy decision that defines the role of the Postal Service. If that is to remain the role of the Postal Service in the future, we need your help and the help of the entire Congress and the Administration to achieve it.

To date, your help has been significant. I appreciate the leadership and support of this Committee through the months of effort that culminated in our thorough and far-reaching Transformation Plan. Your willingness to conduct this hearing so quickly following the Plan's completion demonstrates your commitment to the future of America's mail service.

It is also appropriate at this time to recognize the contributions of so many throughout the entire postal community in developing and completing the Plan we are discussing today.

The Governors of the Postal Service made it clear that the Transformation Plan was their foremost priority. Recognizing the importance of the Plan, they created an environment that encouraged management to take fresh and creative approaches to a wide range of issues that must be addressed to protect our continued ability to provide affordable, universal mail service for all Americans.

Our work in preparing the Plan also involved extensive dialog with members of the mailing community. This included some of the largest mailers in the nation, households and families, and virtually every type of mailer in between. It included organizations and associations that represent the breadth and diversity of the mailing industry. It included our suppliers and vendors. It included our employees and the unions and management associations that represent them. And finally, it included members of Congress and the Administration. We appreciate the time and efforts of everyone who has contributed to the Plan.

We believed it was vitally important that a Plan which set out a future direction for our national postal system included input from everyone with an interest in this vital sector of the nation's infrastructure. To an unprecedented extent, it has brought together an incredibly wide spectrum of needs and visions into a single document. Not surprisingly, continued viability of America's postal system was the common concern of virtually everyone who helped us to prepare the Plan.

It is important to understand that a significant segment of the nation's economy is dependent on a strong and healthy Postal Service. In addition to 750,000 career postal employees, the paychecks of more than eight million Americans are dependent, in whole or in part, on the mail. The mail, and the businesses and services that support it, contribute $900 billion to the economy. In total, this represents eight percent of our gross domestic product.

But the mail represents so much more than a line on an economic graph. The mail represents the commitment of our employees to the ideal that regardless of who you are, rich or poor; whether you live in the largest city or the smallest village; from the remote Alaskan bush to the most distant Hawaiian island; every American has a fundamental right to send and receive mail.

It is in this spirit that I am here today to talk about the Transformation of the Postal Service. Through its more than 225-year history of serving this great nation, the Postal Service has been a valuable national asset. We firmly believe that it can – and will – be an asset for many decades to come. But significant change is necessary for that to occur.

Certainly, change has been a part of the Postal Service's journey through history. We have changed just as America has changed – from the time when mail was carried by horse and rider, to now, when billions of letters routinely travel by air.

We've moved from an era when every piece of mail was handled and processed manually, to a time when letters might go untouched by human hands until they are delivered by a letter carrier – thanks to automation, thanks to our ability to change.

However, as Comptroller General Walker said at that hearing one year ago, the Postal Service's ability to change to the extent required is limited. It is limited by the Postal Reorganization Act, the 1970 legislation that created the modern Postal Service from the heavily subsidized Post Office Department.

The need for transformation is, perhaps, greater today than it was on that July day in 1971 when the new United States Postal Service delivered its first piece of mail. The business model, which was expected to support the new organization into the future, needs modernization today – before we reach a point of no return. That model assumed that continually rising mail volume would result in similarly rising revenue that would support modernization of our national processing system and continuing expansion of the delivery network.

We are now at a point in our history when it is time for another phase in postal evolution. Our 32-year-old operating charter no longer allows us the ability to quickly or effectively adapt in a communications marketplace that could not be imagined more than a generation ago.

The Transformation Plan we presented to Congress last month is about our need to change. It is a blueprint for modernizing every aspect of the way we do business. But the Plan is not about change or modernization for their own sake. It is about the changes required if our public policy continues to be binding the nation together through universal mail service.

The Postal Service is doing everything it can, today and in the near term, to do that. For the longer term, however, we require your help to protect this vital link between individuals, families, and friends, and this key driver of commerce. Our Transformation Plan addresses each of these needs.

We are completing our third year of increased productivity. We have ambitious plans to save an additional $5 billion between now and 2006. This must be done. And we will do it.

There is more we can and must do in the near term. Some of these activities involve tackling the self-imposed restraints that have often prevented us from being as efficient and effective as we can be. To this end, I have lifted the moratorium on closing post offices that management put in place four years ago.

Let me be as clear as I can be on this issue, because it has lent itself to misinterpretation. This does not mean that there will be wholesale post office closings. But it does mean that we will restart the process to close those offices that have been "suspended" or effectively closed, in some cases for more than a decade. In most of those places, we have provided alternative services, often improving customer access to postal products and services.

These alternative services can include extension of rural carrier service from another office, highway contract route delivery, contract stations or the establishment of community post offices. Where carrier service is extended, customers can conduct many postal transactions through their mailbox.

This is consistent with our business strategy, outlined in the Transformation Plan, of providing more convenient access to our system. We want it to be as easy as possible for American people and businesses to use our services – whether through the Internet, through traditional postal retail outlets, or through other retail networks. It is our goal to make postal products – and access to our network – available to our customers when and where they need them – not just where we are located. In too many cases, the network of post offices, developed over many years, over serve some areas and under serve others.

We have agreed to begin an internal review of our retail network with our postmaster groups and the American Postal Workers Union. We will expand the group to include other stakeholders in the near future.

We will also evaluate our existing processing network. With our automated environment and changes in our mail mix, we no longer need some of the 400 processing centers we have nationwide. There are opportunities for consolidations and, with them, cost savings. At the same time, we can optimize our processing network and improve efficiency within processing facilities. Ultimately, this should mean better service for our nation.

In adjusting our network, it is not our intention to reduce delivery to less than six days per week. We do recognize, however, that without needed long-term legislative change, our ability to provide six-day delivery service could be threatened.

We are also going to become even more aggressive in pursuing the benefits our size can bring to our purchasing decisions. We have already leveraged our buying ability to lower our costs for office supplies, telecommunications, equipment and fuel. There are additional opportunities for savings that we intend to pursue.

We will improve our dispute resolution processes and find a way to reduce the $300 million we spend annually on labor-management disagreements. I am excited with the progress that has been made in recent years regarding grievances with our major unions. We will build on this success to look at the entire collective bargaining process. I am grateful that our unions have agreed to sit collectively with management to review opportunities to improve the collective bargaining process. And, by addressing these issues, we can bring improved focus to serving our customers better.

We are also working to modernize the rate process to the extent possible within the existing regulatory framework. George Omas, Chairman of the Postal Rate Commission, showed us that change is possible in this area. Under his leadership, the parties in the recent rate case came together to reach a negotiated settlement and avoided protracted and costly litigation. This was a significant breakthrough and one that I believe signals a new era of cooperation for all parties.

Building upon this historic breakthrough, Chairman Omas and I have agreed to conduct a joint summit of all the stakeholders on May 28 – from large direct marketers, to publishers of small magazines, to individual consumers – to share with us what they believe our industry needs to advance and modernize ratemaking. It is our goal to define the limits of change possible regarding the rates process under the current legislation. And, on the subject of rates, I am committed to maintaining the rates that we will implement on June 30 until at least calendar year 2004.

Industry leaders indicated they recognize the need for Transformation and they pledge to continue this work with us. I was gratified by the level of industry support I encountered two weeks ago at the National Postal Forum in San Diego.

We will continue to refine our systems and processes to improve efficiency, reduce costs, and protect the record levels of service and customer satisfaction we have achieved. We will continue our development of a performance-based culture, one in which compensation and performance are linked. We will continue to use technology to add value to the mail, both by making our system more transparent and expanding the use of automation to all mail streams.

As we work to optimize our network, we are sharing best practices and setting uniform standards throughout the country. If our customers told me one thing at the recent Postal Forum, it was their desire for uniformity in all of their dealings with the Postal Service – from mail entry, to postage payment, to delivery, regardless of which geographic area of the country they are in.

We will also continue to protect our employees and the American people by protecting the safety – and sanctity – of the mail. In this regard, I want to take this opportunity to express my gratitude to this Committee for its support and assistance in obtaining the $500 million homeland security appropriation so necessary to our efforts this fiscal year.

I also want to commend the efforts of the Postal Inspection Service, the Federal Bureau of Investigation, the Bureau of Alcohol, Tobacco and Firearms and the many local law-enforcement agencies who worked together in the successful investigation of the recent pipe bomb incidents. We appreciate the cooperation of our customers and the dedication of our employees during this trying period.

These initiatives represent just a few of the many opportunities available to the Postal Service within the existing legislative and regulatory framework. Despite all of these efforts, however, we will – sooner rather than later – run into the limits of what is possible. If we do not act to move beyond these limits, it is the people and businesses of our nation who will ultimately be affected.

Right now, for instance, we are locked into a pricing system that provides limited flexibility.

Under the current legislation, we do not control our own wages. Too often in our history of collective bargaining, those decisions have been left to a third party to decide.

We do not have the flexibility to grow our business to the extent necessary or to develop new revenue streams. Whenever we attempt to improve, redesign, or introduce products, a host of special interest groups line up to take their best shot to stop us. In the end, the public is not served.

We can make breakthroughs on these issues. But we cannot do it alone. We need the help of our policy makers to legislate postal reforms. If consensus cannot be reached on the right business model for the Postal Service, then we will have allowed a vital, national asset to fail and be wasted.

The nation stands to lose a fundamental government service that we all take for granted: universal mail delivery. That is what our 750,000 employees provide to every American home and business, six days a week.

We agree with the General Accounting Office and with you that we cannot let that happen. We must transform.

After months of gaining input from stakeholders the Postal Service has identified three business models for discussion.

The first model we considered was a privatized mail service.

A privatized Postal Service would be shareholder-owned. As such, it would focus on profit. Financial, service and operational decisions would be made within that context. The results might be delivery standards and prices dictated by where a person lives or where a business is located. Metropolitan areas where volume is greater could receive better or cheaper service than a rural community. And, like any privately owned business, it could thrive or fail.

The people we reached out to in creating our Transformation Plan told us, overwhelmingly, that there was no support for privatizing the nation's mail service. People speak of a digital divide; we do not need a delivery divide.

The American people told us they strongly support the present definition of universal service at affordable rates. People have come to rely on uniformly priced letters for national delivery.

The second alternative model explored in our Transformation Plan is the restructuring of the Postal Service as a traditional government agency. A sizable portion of our operating revenues would come from appropriated funds rather than from income produced by providing a wide range of services.

We believe this option comes with an unacceptable price. In this case, the solution to decreasing mail volume and rising rates would be direct subsidies, tax dollars; in effect, putting the Postal Service back on the federal budget.

That would take us back to the model of the 1960s when the Post Office Department was dependent on taxpayers to underwrite the cost of universal service. Remember, no taxpayer dollars go to fund our normal operations. They are funded from the sale of stamps and our other products.

Imagine, if you will, the Postal Service going through an annual appropriations process and asking Congress to fund 25 percent of its operating budget. That would amount to $15 billion in Fiscal Year 2003 terms.

During the 1960s, the old Post Office Department received up to 25 percent of its Operating revenues from taxpayers. That meant that when the Postal Service was created in 1971, the price of an eight-cent postage stamp was actually ten cents. The first eight cents of the stamp price was paid for at the post office counter. The remaining two cents was paid for on April 15.

You'll recall that service in the 1960s had declined due to an inability to make capital investments to modernize processing facilities and grow our infrastructure as mail volume grew. In addition, our employees' wages were depressed.

It wasn't good for America then, and it wouldn't be good for America today.

Frankly, that's where we are heading if we are unsuccessful in providing the Postal Service the flexibility it needs to operate successfully in today's environment.

We provided a third alternative in the Plan, a Commercial Government Enterprise. It is the model we believe would put the Postal Service on a more businesslike footing, while keeping it dedicated to its mission of universal service.

It is a model that is markedly different from what we have today. For example, instead of breaking even, our financial goal would be to generate "reasonable returns." Earnings would finance capital projects; we would not have to resort to increasing debt for this purpose. Retained earnings would enable us to finance operations through difficult economic times, rather than having to always resort to increasing postage rates.

In addition, this model would allow us to utilize our vast retail and delivery assets to develop new revenue streams. Our 38,000 retail offices and our national door-to-door delivery networks could be made available to private enterprise as a joint, profit making venture.

As a commercialized government enterprise, we could introduce flexible pricing. Prices for postal products would still be subject to regulatory review. But we would have the flexibility to adjust prices based on market demand.

Next, as a labor intensive organization, with 75 percent of our operating expenses going to labor, this business model would allow us to explore a more progressive way to make collective bargaining work for all parties.

Finally, this model would give us the needed flexibility to increase access and convenience for our customers. Management would have the flexibility to close a number of non-performing retail outlets. And we would be able to invest in new facilities and services and enter into alliances and ventures with related, private-sector companies, after due diligence was completed.

Essentially, this "commercialized Postal Service" would provide the management tools that are available to private-sector businesses as we work to improve service to our customers, manage costs more efficiently and leverage our assets to generate new revenue opportunities.

Ultimately, this model would permit us to make maximum use of our assets and enable the nation to share in the benefits of our scope – every home, every business, every day, and in every retail outlet. At the same time, it would protect our ability to serve every home, every business every day – at a broader range of outlets than ever before.

Every American and every policy maker needs to be involved in these discussions. The future of affordable, universal mail service depends on it.

We pledge to do our part. We pledge to continue our strong performance focus. We pledge to make changes that are possible within the framework of the existing legislation and work with the Administration and Congress to bring about legislative reform to achieve this transformation.

We recognize the efforts of both the Senate and the House of Representatives in advancing the debate on postal reform. We acknowledge and appreciate the thoughtful and far-reaching efforts of many Members to reach consensus on various reform vehicles. We believe that these efforts should include serious consideration of the structural models in the Transformation Plan. I offer my assistance and that of the entire Postal Service to that end.

We cannot afford to let this opportunity pass us by. We cannot afford to risk the legacy of more than 200 years of universal service. The decisions we make today will affect the future of America's mail system for generations to come. If this national asset is to be protected and preserved, then action is needed.

In the difficult months since September 11, it has become clear to all of us that the world has changed. For the United States Postal Service, the anthrax attacks, one month later, were a stark confirmation that we cannot do business as usual anymore. That realization is firmly rooted in us now as never before.

I am convinced that this plan for transformation is a key step in moving past our limitations, as we work to define and embrace sorely needed changes. With courage and conviction, we can continue to connect our people, our neighborhoods, our communities – indeed, the whole nation – as no one else can, just as we have for more than two centuries.

I appreciate the opportunity to share my thoughts with you today and I look forward to continuing this important conversation with you. In particular, I look forward to working with this Committee to explore how we can provide the American people with a continued, strong postal system.

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United States General Accounting Office

GAO

Testimony

Before the Subcommittee on International Security, Proliferation and Federal Services, Committee on Governmental Affairs, U.S. Senate

For Release on Delivery
At 10:00 a.m. EDT
Monday,
May 13, 2002

U.S. POSTAL SERVICE

Moving Forward on Financial and Transformation Challenges

Statement by David M. Walker
Comptroller General of the United States

GAO-02-694T

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to participate in this hearing on the financial and transformation challenges facing the U.S. Postal Service (the Service). Since we discussed these issues about a year ago, when we placed the Service's long-term outlook and transformation efforts on our High-Risk List, the Service's financial situation has continued to decline, and its operational challenges have increased. As we recently reported, the need for a comprehensive transformation of the Service is more urgent than ever.[1] The Service has also recognized the need for reexamining and changing its existing business model. Last month, the Service took a good first step when it issued its Transformation Plan. The plan provides a wealth of information about the Service's challenges, identifies numerous actions the Service plans to take under its existing authority, and outlines steps that would require congressional action. At the same time, the plan does not adequately address certain key issues or include an action plan with key milestones, which will be critical to assuring success and assessing progress. In my testimony today, I will focus on the Service's current financial outlook, which includes updated information since our report was issued. I will also offer observations on the Service's Transformation Plan.

Summary

Overall, the Service continues to have significant difficulties in getting its financial house in order. Specifically:

- The catastrophic events of September 11 and subsequent use of the mail to transmit anthrax, plus the recent economic slowdown, have served to exacerbate the Service's financial

[1] U.S. General Accounting Office, *U.S. Postal Service: Deteriorating Financial Outlook Increases Need for Transformation*, GAO-02-355 (Washington, D.C.: Feb. 28, 2002).

difficulties by decreasing mail volumes and revenues. Only time will tell how much of this decline is temporary and how long it will last.

- Despite additional cost-cutting efforts in the first half of fiscal year 2002, the Service's revenues declined approximately twice as fast as its expenses, in part because the Service has large fixed expenses that are difficult to cut in the short term.
- The Service's budget, prepared before September 11, estimated a $1.35 billion deficit for fiscal year 2002, which was recently updated to an approximately $1.5 billion deficit. The Service is headed for its third consecutive annual deficit since fiscal year 2000 despite multiple rate increases over this period.
- Productivity increases continue to be difficult to achieve and sustain. During the first 2 quarters of fiscal year 2002, productivity fell below budgeted targets. For example, in the first quarter, which was affected by the extraordinary events of last fall, productivity fell by 1.1 percent compared with a budgeted 1 percent increase. In the second quarter, productivity rose by 1 percent but was budgeted to rise by 1.5 percent.
- Cash flow difficulties continue. However, Service officials express confidence that the Service can pay its bills in fiscal year 2002 through postal revenues and borrowing.
- The Service's debt is budgeted to rise to $12.9 billion by the end of fiscal year 2002, up $1.6 billion from the previous year and only $2.1 billion less than the $15 billion statutory limit. To put this situation into context, one biweekly postal payroll exceeds $1 billion. In addition, as we testified a year ago, the Service does not have a debt reduction plan.
- To conserve cash and limit debt, the Service has continued its freeze on capital spending for most facility projects, resulting in a growing backlog—a situation that is unsustainable. Meanwhile, total capital outlays are budgeted to decline in fiscal year 2002 for the third consecutive year to $2.2 billion. This level of capital investment is inadequate for the Service

to maintain and modernize its infrastructure and meet other capital needs. It could also limit the Service's ability to cut costs and achieve productivity gains as well as undertake major transformation efforts involving its retail and mail-processing infrastructure.

- As the Service considers its infrastructure and capital investment needs, it has the opportunity to rationalize its infrastructure to provide more points of service while also reducing costs associated with "brick and mortar" facilities. Further, it can consider how best to enhance mail safety and security as it assesses its facility needs.
- The Service's major liabilities and obligations are estimated at close to $100 billion, which include liabilities for pensions, workers' compensation benefits, and debt to the Treasury; and other obligations for post-retirement health benefits.
- The Service's financial condition is deteriorating as it liabilities continue to exceed its assets. The Service's governmental status provides insulation from the bankruptcy process that would be applicable to private sector companies in a similar condition. Addressing the underlying factors that are driving the Service's financial condition cannot be ignored and is in large part what transformation must be about.

The Service's financial difficulties are not just a cyclical phenomenon that will fade as the economy recovers. The Service's basic business model, which assumes that rising mail volume will cover rising costs and mitigate rate increases, is increasingly questionable as mail volumes stagnate or deteriorate in an increasingly competitive environment. For example, alternatives to hard-copy mail are proliferating and include numerous alternatives such as electronic mail, automated bill payment and electronic presentment, faxes, and cell phones with rates that do not include extra charges for long-distance minutes.

The Service's Transformation Plan recognized that postal costs are rising faster than revenues and identified numerous actions that the Service plans to take under its existing authority, notably through cutting costs and improving productivity. Historically the Service has had difficulties in cutting costs and achieving and sustaining increases in its productivity. In addition, the Service faces growing retirement-related costs and potentially significant costs to improve the safety and security of the mail. The plan stated that the Service expects to achieve $5 billion in savings and cost avoidance through 2006. However, it is unclear from the Service's Plan whether the cost cutting goals will be sufficient for the Service to hold rates steady from mid 2002 calendar year until 2004, as it has planned, and reduce debt and finance needed capital investments. In addition, it is unclear what the potential financial impact would be, particularly in the short-term, from the Service's planned actions during the transformation period. More specifically, it is unclear what the impact of planned actions would be on annual revenues and expenses or when financial benefits may be realized. Further detail on the costs and time frames associated with specific initiatives would be useful to better understand the financial impact of the Service's planned actions.

Overall, the Postal Service is to be commended for raising key postal reform issues in its Transformation Plan, suggesting near-term legislative changes, and outlining the statutory model that the Service would prefer for its long-term future. The plan contained many good suggestions and planned actions on short-term actions to improve efficiency. (See app. I for key problems that we have identified and actions and milestones in the Service's Transformation Plan to address them.) The plan also raised some difficult long-term issues, such as the Service's legal requirements and practical constraints that limit transformation efforts. Further, the plan's appendixes contained useful descriptions of actions the Service plans to take, such as its

strategies to improve efficiency and develop a performance-based culture. Other appendixes contained detailed background information and discussed how foreign postal administrations have dealt with similar postal reform issues.

However, the plan did not adequately address some key transformation issues that will need to be addressed for any transformation effort to be successful. These issues include the definition of universal postal service; strategies to address certain human capital matters such as postal pay comparability, performance management issues, management bonus arrangements, and workforce deployment and utilization; the Service's governance structure, transparency, and accountability mechanisms; and what mechanisms would be best suited for making progress on unresolved transformation issues. Although the Transformation Plan recommended that Congress give the Service much more flexibility, particularly in the ratemaking and new products areas, it will be important that any additional flexibility be coupled with an appropriate level of transparency and accountability.

Where do we go from here? As the Service's Transformation Plan emphasizes, the Service can and should make progress on the specific actions it can take under its existing authority. Much progress can be made through exploring constructive partnerships and relationships between the Service and other key stakeholders, such as the mailing community and the Postal Rate Commission (PRC). We applaud these parties for taking constructive steps in this direction. Similarly, we encourage the Service and its major labor unions and management associations to build on their post-September 11 working relationship by working in a partnership fashion to discuss and move forward on difficult human capital issues. The Service also needs to work with Congress to address a range of unresolved transformation issues. More specific steps, time

frames, and information on expected financial impacts is needed in order for Congress to effectively monitor the Service's progress in implementing its plan.

Further, progress on comprehensive legislative reform has been difficult to achieve, in part because numerous stakeholders have divergent needs and concerns. Given the vital role of the nation's postal system to the American people and businesses, I urge the parties to find common ground in building a viable postal system for the 21st century. The time has come for comprehensive and fundamental reform. As we have stated previously, this will likely require a special commission to address the most difficult and controversial issues that must be addressed (e.g., defining universal service and rationalizing infrastructure). Make no mistake about it, shared sacrifice from all stakeholders will be necessary to achieve a successful postal transformation.

The Service's Current Financial Situation

Overall, the Service's financial condition has continued to decline. Large deficits continue as volumes and revenues decline; rates and debt are spiraling upward; capital needs are going unmet; and the Service's liabilities exceed its assets. Despite multiple rate increases, the Service's net income continually declined from fiscal year 1995 through fiscal year 2001(see fig. 1). The rate increase implemented in 1995 averaged 10.2 percent and was the largest percentage rate increase during this period. Costs, in general, have been difficult to reduce in the short term since the Service has high fixed costs, such as 6 days per week delivery of mail to approximately 138 million addresses—a figure that grows by nearly 2 million annually—and maintenance of a national retail infrastructure of 38,000 post offices, branches, and stations. The Service is also

nearing its $15 billion statutory debt limit. To conserve cash, it is cutting back on its capital outlays, which will hinder modernization of the Service's infrastructure.

Figure 1: Postal Service Net Income/Losses from Fiscal Years 1972 to 2002

Source: Postal Service.

Factors Affecting the Service's Net Income for Fiscal Year 2002

In its budget prepared before September 11, the Service estimated that it would incur a $1.35 billion deficit in fiscal year 2002, and recently updated its deficit estimate to approximately $1.5 billion. The Service reported almost a $200 million deficit for the first 2 quarters of fiscal year 2002 combined. The Service recently estimated that it would lose an additional $400 million to $800 million in the third quarter. Similarly, the Service has not updated its outlook for the fourth

quarter—which has a budgeted $1.4 billion deficit.[2] It should also be noted that mail volumes in the third and fourth quarters may fall below the budget targets if current trends persist.

Further, productivity increases continue to be difficult to achieve and sustain. During the first 2 quarters of fiscal year 2002, productivity fell below budgeted targets. For example, in the first quarter, which was affected by the extraordinary events of last fall, productivity fell by 1.1 percent, compared with a budgeted 1 percent increase. In the second quarter, productivity rose by 1 percent but was budgeted to rise by 1.5 percent. Productivity targets for the remainder of this fiscal year are budgeted to decline.

On the other hand, the fourth quarter deficit is estimated to be offset by about $1 billion in additional revenues from the rate increase scheduled to occur June 30, 2002. Thus, the Service will have implemented multiple rate increases since January 2001 (see table 1). The scheduled increase averages 7.7 percent for all rates. In addition, the price of a First-Class stamp will increase by 3 cents, that is—an 8.8 percent increase. Despite this rate increase, the Service is headed for its third consecutive annual deficit.

Table 1: 2001 and 2002 Rate Increases

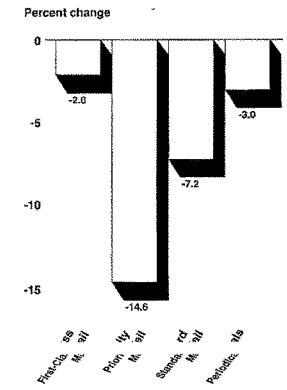
Date	Details of rate increases
January 7, 2001	Service implemented rate increases averaging 4.6 percent, with a 1-cent increase in the First-Class stamp rate to 34 cents.
July 1, 2001	Service implemented rate increases averaging 1.6 percent.
June 30, 2002	Service is to implement rate increases averaging 7.7 percent, with a 3-cent increase in the First-Class stamp rate to 37 cents.

Source: Postal Service.

[2] In fiscal year 2001, the Service reported a $1.68 billion deficit, including a $256 million deficit in the first 2 quarters, $166 million deficit in the third quarter, and a $1.26 billion deficit in the fourth quarter.

The Service's poor financial outlook for fiscal year 2002 was compounded by further declines in mail volume in the wake of incidents of terrorism, including anthrax in the mail, and the economic slowdown. Total mail volume declined 4.5 percent in the first 2 quarters of fiscal year 2002, compared with the first 2 quarters in the previous fiscal year, while total revenues declined 0.4 percent—a revenue decline that was mitigated by rate increases implemented in January and July 2001 that averaged a cumulative 6.2 percent. Mail volumes declined in the first 2 quarters of fiscal year 2002 for First-Class Mail, Priority Mail, Standard Mail (primarily advertising), and Periodicals (see fig. 2), leading to little revenue growth or declining revenues in each of these categories. Only time will tell how much of the recent volume decline is temporary and how long it will last. (See app. II for details on mail volumes and revenues in the first 2 quarters of fiscal year 2002.)

Figure 2: Change in Selected Mail Volumes for the First 2 Quarters of Fiscal Year 2002 Compared with the Same Period in Fiscal Year 2001



Source: Postal Service.

On the positive side, the Service has budgeted and achieved significant cost cutting in fiscal year 2002. For the first 2 quarters of fiscal year 2002, the Service reported that its total costs were 2.7 percent below its budgeted estimates. The Service reported that it reduced budgeted costs by decreasing the number of career employees and by reducing work hours including overtime. The Service had nearly 16,000 fewer career employees at the end of the second quarter, compared with the same period for fiscal year 2001, a decline of about 2 percent. Likewise, total work hours— including both career and noncareer employees— fell by nearly 40 million in the first 2 quarters, a decline of 5.1 percent. Service officials have said that these workhour savings were achieved in part because the Service had less mail to deliver than it did a year ago, and in part through efforts to improve the Service's efficiency. For example, mail processing work hours fell by 8.1 percent in the first 2 quarters of fiscal year 2002, compared with the same period in fiscal year 2001, a gain aided by initiatives such as deployment of more efficient machines to sort flat-sized mail (e.g., large envelopes and periodicals). To make further progress in improving efficiency, the Service could explore issues related to having sufficient flexibility to redeploy staff as mail volumes fluctuate.

In addition to financial difficulties, the Service has also experienced some slippages in service performance. Although the Service has maintained high service levels for delivery of overnight First-Class Mail, its on-time delivery scores for 2-day and 3-day First-Class Mail have generally declined since fiscal year 1999. For example, on-time delivery of 2-day First-Class Mail in the first quarter declined annually from a peak of 86 percent in fiscal year 1999 to 82 percent in fiscal year 2002. Likewise, on-time delivery of 3-day First-Class Mail in the first quarter declined annually from a peak of 87 percent in fiscal year 1999 to 72 percent in fiscal year 2002. Similar, but less pronounced, trends applied in the second quarter over this period. The most

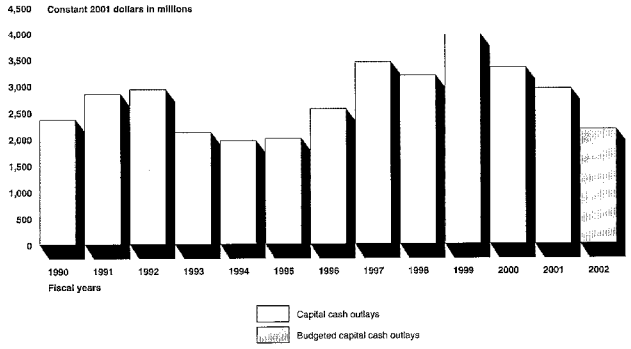
recent available data for the second quarter of fiscal year 2002 show on-time delivery of 82 percent for 2-day First-Class Mail and 74 percent for 3-day First-Class Mail. (See app. III for detailed service performance data.) Recently, security restrictions were imposed after September 11 that barred First-Class Mail weighing over 16 ounces from transportation on commercial airlines so that the Service increased its reliance on trucks. It is unclear whether these shifts in transportation modes have also affected on-time delivery of other types of mail, such as the continuing erosion of on-time delivery performance for Priority Mail.[3]

The Capital Investment Outlook

The Service's capital investment program continues to be severely limited by the Service's financial problems. The Service budgeted $2.2 billion for capital outlays in fiscal year 2002, down from $2.9 billion in fiscal year 2001, and $3.3 billion in fiscal year 2000 (see fig. 3). Budgeted capital cash outlays for fiscal year 2002 are at the lowest level since fiscal year 1995.

[3] For trends in Priority Mail service, see *Report of the Consumer Advocate on Quality of Services Provided by the Postal Service to the Public* by the PRC Office of the Consumer Advocate (Mar. 6, 2002).

Figure 3: Postal Service Capital Cash Outlays, Fiscal Years 1990 through 2002



Note: Figures were calculated using a chain-type price index for Gross Domestic Product as computed by the U.S. Department of Commerce. The fiscal year 2002 figure was calculated using an estimate from the Congressional Budget Office.

Source: Postal Service.

The Service has continued its capital freeze for most facility investments to save cash and limit debt, resulting in a growing backlog in planned facilities. Limitations on capital investment may have a number of detrimental effects such as deterioration of the Service's existing physical infrastructure, deferred efficiency gains, and higher future capital costs. Looking forward, the gap between resources and capital investment needs would be exacerbated by the Service's plans to continue automation efforts, deploy an "information platform" to provide better information on postal operations and the status of mail, and implement any modernization or restructuring of the Service's infrastructure.

Another concern is that the Service has continued to rely on debt to finance its capital program. This trend could not continue if the Service reaches its $15 billion statutory debt limit. The Service's debt is budgeted to increase by $1.6 billion and reach $12.9 billion by the end of fiscal

year 2002, only $2.1 billion below the $15 billion statutory debt limit. Even the remaining $2.1 billion in borrowing authority may not be available for capital investment in future years, since fiscal prudence might suggest stabilizing debt below the statutory limit to maintain liquidity. Further, the Service has said that its goal is to reduce debt, which might preclude the use of additional debt to finance capital investment. The Service's Transformation Plan stated that "Since cash flow from operations is linked to net incomes (or losses), stabilizing and reducing debt will require that the Postal Service recover its prior years losses and carefully plan its capital cash outlays so they do not exceed cash flow. As the past two fiscal years have demonstrated, the Postal Service cannot simultaneously generate net losses and reduce its borrowings."

Looking ahead, expenses related to enhancing mail safety and security are a key unknown cost factor. To date, the Service has relied primarily on congressional appropriations to finance capital investment in measures designed to improve mail safety and security. However, uncertainties remain regarding the technologies to be deployed, the associated capital costs, the subsequent impact on operating costs and postal operations, and the extent to which Congress will pay for these costs in the future. The price tag is likely to be substantial, with the Service requesting about $800 million in supplemental appropriations for fiscal year 2003 to improve mail safety and security. This request is in addition to the $675 million that was appropriated in fiscal years 2001 and 2002 for security purposes.

Another uncertainty that may affect the Service's capital program involves its request for nearly $1 billion in congressional appropriations for revenue foregone,[4] which the Service has said

[4] The Service has asked for nearly $1 billion in fiscal year 2003 appropriations for the total amount of revenue forgone for free and reduced rate mail between 1991 and 1998 for which the Service has not yet received

could be used to finance some capital facility projects. Specifically, the Service has proposed accelerating payments for revenue foregone from $29 million annually through 2035 to a single lump-sum payment in fiscal year 2003—a change that would increase the net present value of appropriations received by the Service for this purpose.[5] Congress did not act on a similar proposal last year and has not acted on the Service's latest request.

Addressing the Service's Financial Problems

In the short term, the Service may have to rely primarily on cutting costs and raising rates to address its financial problems. The Service's Transformation Plan identified numerous short-term steps the Service plans to take under its existing authority to cut costs and improve productivity. Regarding rate increases, an above-inflation rate increase averaging 7.7 percent is scheduled to take effect June 30, 2002, including a 3-cent increase in the price of a First-Class stamp from 34 to 37 cents. However, raising rates may cause mail volumes to decrease and encourage mailers to shift more mail to electronic and other delivery alternatives. Although the Service plans to hold rates steady from June 2002 until calendar year 2004, pressures to increase rates will continue in the long term to cover rising expenses, such as wage increases and growing long-term obligations. The Service's total liabilities on its balance sheet were $61 billion, which exceeded total assets by $2.3 billion at the end of fiscal year 2001.[6] These liabilities include $32

appropriations. This request would be in lieu of the current payment schedule established by a 1993 law for $29 million in annual appropriations over 42 years.

[5] The present value of remaining payments of revenue foregone is $422 million (at an interest rate of 5.8 percent) according to a recent Congressional Research Service report. See *The Postal Revenue Foregone Appropriation: Overview and Current Issues*, by the Congressional Research Service (CRS Report RS21025, Updated November 23, 2001).

[6] Total assets on the balance sheet include a $32 billion deferred retirement asset, which is an intangible asset that is not an economic resource that can be applied to cover the Service's liabilities.

billion for pensions,[7] $6 billion for workers' compensation benefits, and $11 billion for debt to the Treasury. In addition, the Service has other major obligations estimated at $49 billion for post-retirement health benefits.[8] These liabilities and obligations amount to almost $100 billion and threatens the Service's ability to continue to fulfill its mission by providing the current level of universal postal services at reasonable rates on a self-supporting basis.

In the long term, the Service's Transformation Plan recognizes that the Service's basic business model is not sustainable and that much larger declines in mail volume may be in the offing if mailers increasingly shift to various electronic and other alternatives. Both the Service and we agree that some progress is possible within the current structure, but that a comprehensive postal transformation will be required to fully address the Service's financial viability and the statutory framework under which the Service operates. In our view, modest tinkering with the existing system will be insufficient to produce a lasting comprehensive transformation that will enable the Service to fulfill its mission in the 21st century. The time has come for comprehensive and fundamental reform. As we have stated previously, this will likely require a special commission to address the most difficult and controversial issues (e.g., defining universal service and infrastructure rationalization).

[7] In addition to the $32 billion in pension liabilities, the Service would also pay $16 billion in associated interest if the Service made the annual scheduled minimum payments over the amortization periods prescribed by statute.

[8] The Office of Personnel Management recently told us that its estimate of the Service's post-retirement health benefits obligation was about $49 billion as of September 30, 2000, of which about $17 billion was attributed to current retirees. The Service's financial statements do not record or disclose an obligation for retiree health benefits, because the Service accounts for its participation in the Federal Employees Health Benefits Program as participation in a multi-employer plan. Thus, the Service reports that it is not required under accounting standards to include post-retirement health benefits obligations in its balance sheet.

Moving Forward to Transform the Postal Service

Given the Service's deteriorating financial situation, progress on comprehensive transformation is urgently needed, and the Transformation Plan has made a valuable contribution by identifying numerous specific steps for making improvements within the current structure. The Service is to be commended for raising controversial issues in its Transformation Plan and taking positions on the changes that it believes are necessary. The Service's Transformation Plan conveyed a needed sense of urgency when it stated that over the next 2 to 3 years, it is vital that significant progress be made toward defining the long-term structure and role of the Postal Service. To that end, the plan made a range of recommendations to deal with transformation issues through near-term regulatory and legislative reforms and long-term legislative solutions. For the near-term, the plan recommended changes that would give the Service more flexibility in ratemaking, facility closings, purchasing, labor negotiations, and other employment areas. For long-term change, the plan outlined three options and noted the Service's preferred option—a "Commercial Government Enterprise." Under this option, the Service would remain an independent establishment of the federal government but would be structured and operated in "a much more businesslike manner." In addition, the plan contained useful discussions in detailed appendixes, such as how foreign postal administrations have dealt with similar postal reform issues.

Although the Transformation Plan dealt with many difficult issues, it did not include an adequate discussion of specific plans or proposals related to some key transformation issues, including the following:

- the future nature of universal postal service, including its retail and delivery components, and the associated infrastructure;

- several key human capital issues such as postal pay comparability, performance incentives, labor-management relations, workforce realignment, and management bonus arrangements;
- various governance, accountability, and transparency issues; and
- a detailed action plan and recommendations on what mechanisms would be best suited for making progress on certain transformation issues beyond the Service's direct control.

Most importantly, the plan recognized the need for defining universal service but declined to propose a definition of future universal postal retail and delivery services for consideration. More clarity about the scope and quality of universal postal services is needed to facilitate consideration of a range of critical infrastructure and human capital issues. Further, although the Transformation Plan recommended that Congress give the Service much more flexibility, particularly in the ratemaking and new products areas, it is important that any additional flexibility be coupled with an appropriate level of transparency and accountability—issues that the Transformation Plan had less to say about. Because these issues are also critical to postal transformation, I will offer some brief observations about them in this testimony. Our recently issued report contains a more comprehensive discussion of these and other transformation issues.[9]

Universal Service and Infrastructure Issues

Vast changes in the communications and delivery sectors over the past 30 years—which are continuing at a rapid pace—as well as the Service's growing financial difficulties, provide an impetus for reconsidering what universal postal services will be needed for the 21st century. Key

issues include what postal services should be provided on a universal basis to meet customer needs, how these services should be provided, and how they should be financed—by ratepayers or taxpayers. Some related issues include what quality of universal postal service should be maintained—such as the frequency and speed of mail delivery, the accessibility and scope of retail postal services—and whether certain aspects of universal postal service should be allowed to vary in urban and rural areas. In this regard, it will be important to understand the current situation and opportunities for improvement.

The Service is planning to conduct an assessment of its retail, mail processing, and transportation networks that is likely to provide useful information to Congress and stakeholders including the public on areas where service may be redundant, as well as areas where more or better service may be needed. Some benefits that may result from reassessing universal postal service might be maximizing the use of facilities and reducing costs while also improving service. This could be accomplished through the provision of more points of service, improved hours of access, and greater customer convenience to some postal retail services while reducing their cost, as compared with more traditional means of service delivery through "brick and mortar" facilities. For example, the Transformation Plan contained useful discussion about ways to enhance access and reduce the cost of some routine postal services, such as providing stamp sales at grocery stores and through ATMs, making vending machines for stamp purchases available 24 hours a day, and deploying self-service equipment that can be used to mail packages while reducing the anonymity of this mail.

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[9] GAO-02-355.

We recognize that universal postal service issues are highly sensitive, given the long-standing role that the Service plays in providing essential communications and delivery services to communities across the nation. To make progress in modernizing the infrastructure to support universal postal service—such as the national network of post offices that provide universal access to postal retail services—it will be important for the Service to engage in frank and open discussions with all stakeholders, including the Congress, on issues related to universal postal retail and delivery service. Rationalizing the Service's infrastructure may entail closing or consolidating certain facilities where there is excess capacity while adding new facilities to address unmet needs, such as in growing areas. Given the difficulty of these issues, Congress could establish a mechanism similar to that used for closing military bases to make progress in this important area. Such a process has been used to overcome public concern about the economic effects of closures on communities and the perceived lack of impartiality of the decision-making process. Under this process, Congress could consider a proposed package of closures and consolidations with an up-or-down vote.

Human Capital Challenges

Strategic human capital approaches must be at the center of efforts to transform the culture of federal entities, including the Postal Service. Like the rest of the federal government, the Service's human capital challenges are long-standing and will not be quickly or easily addressed. To link human capital strategies to accomplishing organizational goals and objectives, we have developed a model of strategic human capital management.[10] This model may be useful for the Service as it develops its strategic human capital planning, including a long-term workforce plan.

Such strategies would address workforce realignment, aligning individual performance with organizational objectives, performance incentives, and pay comparability.

Making changes to the Service's human capital, or workforce, will include the challenge of dealing with legal requirements and practical constraints. For example, the Service is required by law to maintain employee compensation and benefits on a standard comparable to the compensation and benefits paid for comparable levels of work in the private sector. In addition, when contract disputes cannot be settled between postal labor and management, they must be settled by a third party through binding arbitration. Further, as a practical manner, labor unions and management within the Service have had long-standing adversarial relations. As an example of these limitations, the Service and its major employee unions have often disagreed about how the pay comparability standard should be applied and presented voluminous and contradictory evidence when they have taken this matter to binding arbitration.

In addition to compensation, labor-management differences have extended to performance management issues involving incentives and benefits as well as deployment and use of the workforce. Performance management systems can include pay systems and incentive programs that link employees' performance to specific results and desired outcomes. In this regard, the Transformation Plan recognized the need for a performance-based culture, noted that continuing to improve efficiency and customer value is contingent on exceptional performance by the Service's employees, and addressed plans for a new performance management system for managers. However, the plan did not discuss how performance-based compensation and

[10] U.S. General Accounting Office, *A Model of Strategic Human Capital Management,* GAO-02-373SP (Washington, D.C.: Mar. 15, 2002).

incentive systems might cascade throughout the organization—an issue that Service managers and unions have repeatedly disagreed on in the past.

For transformation to be successful, it is vital for the Service and its unions to share a common vision for the future and a shared responsibility for finding solutions to the Service's financial and workforce problems. As I testified before this subcommittee in March, committed, sustained, and inspired leadership and persistent attention will be essential if lasting changes are to be made in the human capital area.[11] In that vein, the postmaster general, postal officials, and leaders of postal labor unions and management associations demonstrated a positive and constructive approach by holding daily meetings last fall to deal with issues related to mail safety and security. The recent announcement of a tentative negotiated settlement of contract talks between the Service and the National Association of Letter Carriers was another positive example. These parties also recently agreed on steps to streamline grievance and arbitration procedures to limit the number of unresolved issues at the local level and reduce the time in handling such disputes. These are positive steps that provide a foundation on which to build; however, much remains to be done.

Governance, Transparency, and Accountability Issues

Congress has recently been focusing significant attention on corporate governance, transparency, and accountability issues in light of Enron's recent decline. Recent events have raised a range of questions regarding what can happen when one or more key players fail to adequately perform their responsibilities. I want to underscore that serving on a board of directors is an important

and difficult responsibility that requires being knowledgeable about the industry and finances, asking the right questions, and doing the right thing to protect the public interest. This responsibility is especially challenging in directing the Service, which is facing increasing competition in a rapidly changing market environment. In addition, the board's audit committee has an important role to play in ensuring fair presentation and appropriate accountability of management in connection with financial reporting, internal control, compliance, and related matters.

We believe that a range of governance issues needs to be addressed as part of the Service's transformation plan. However, the Service's transformation plan had little to say on these matters other than proposing that the Service be transformed into a Commercial Government Enterprise that would act much more like a business, and, as part of that proposal, its board of governors would be "refocused on fiduciary duties." Under its current framework, the Service is intended to function in a businesslike manner, which raises the following questions related to its governance structure:

- What type of governing board would be most appropriate considering the Service's size, importance, and challenges?
- How should board members, including the postmaster general and deputy postmaster general, be selected, paid, and held accountable?
- What should be the roles and functions of the governing board, and is its current part-time status appropriate?
- Is the present governance structure best suited to selecting well-qualified individuals to direct a $70 billion entity? Or, should the framework follow recent changes in the private

[11] U.S. General Accounting Office, *Managing for Results: Building on the Momentum for Strategic Human Capital*

sector to (1) develop better-defined criteria for board membership and (2) recognize that various roles on the board may require certain specific backgrounds and skills?

Transparency and accountability are fundamental principles to ensuring public confidence in the Service. As part of the proposed change to a more commercial enterprise, questions remain related to whether the Service should be held more directly accountable for its performance and if so, to what extent, to whom, and with what mechanisms. Other questions include

- What oversight is needed to protect the public interest, including the interest of customers with few or no alternatives to using the mail?
- How should the PRC and/or other pertinent authorities exercise oversight regarding pricing, competition, and antitrust issues, among other areas?
- What recourse should customers and competitors have to lodge complaints?
- What should be the role of Congress and other federal agencies in providing oversight and accountability?
- What information should the Service be required to provide Congress and the public on its performance, including areas such as financial performance, productivity, and mail delivery?

Another issue we have noted, related to transparency and accountability, involves improvements needed in the Service's financial reporting. The principles for the Service's financial information are the same as those in our recent testimony on financial reporting issues: financial statements, which are at the center of present-day business reporting, must be timely, relevant, and reliable to

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Reform, GAO-02-528T (Washington D.C.: Mar. 18, 2002).

be useful for decision-making.[12] We have recently reported that the Service's financial outlook was repeatedly revised in fiscal year 2001 with little or no public explanation and that greater transparency is needed regarding the Service's financial and operating results and projections. Accordingly, we have recommended that the Service improve the transparency of its financial information by providing monthly and quarterly financial reports in a user-friendly format on its Web site in a more timely manner.[13]

The Service has agreed with our recommendation to improve the transparency of its financial data and stated that it was providing financial reports on its Web site in a more timely and user-friendly manner. To date, the Service has begun to provide monthly financial reports on its Web site. It has also provided one quarterly financial report—for the third quarter of fiscal year 2001. Currently, the Service has posted on its Web site the chief financial officer's financial presentation for the second quarter of fiscal year 2002. This presentation has less information than the previous publicly available quarterly report—it does not include cash flow data, year-to-date analysis, or changes in outlook. In our opinion, this publicly available information has not provided sufficiently detailed information for stakeholders to understand the Service's current and projected financial condition or how its financial outlook has changed. More timely, accessible, and reliable financial information is sorely needed.

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[12] U.S. General Accounting Office, *Protecting the Public's Interest: Considerations for Addressing Selected Regulatory Oversight, Auditing, Corporate Governance, and Financial Reporting Issues*, GAO-02-601T (Washington, D.C.: Apr. 9, 2002).

[13] GAO-02-355.

Next Steps

Stakeholders are looking for positive, constructive ways to work through difficult postal transformation issues and the Service's Transformation Plan was a good start. Many postal transformation issues are complex, and consensus is likely to be hard to achieve on key areas such as a new definition of universal postal service, the associated infrastructure, human capital, governance, accountability, and transparency issues, among others. Further, a successful transformation of the Service will require shared sacrifice. However, given the vital role of our postal system in communications and commerce, and the Service's declining financial outlook, it's time for all stakeholders to roll up their sleeves and engage in postal transformation issues. In this regard, we note that the Service and mailers have already made progress, such as through the Mailing Industry Task Force, in identifying concrete ways to enhance efficiency and improve the value of the mail. We also applaud the initiative of the Postmaster General John Potter and PRC Chairman George Omas in agreeing to convene a summit to discuss ways to improve the rate structure and the rate setting process. The Service has a similar opportunity to build working partnerships with its major labor unions and management associations so that the parties can make progress on human capital issues.

Another critical partnership involves the Congress and postal stakeholders in working through a range of important, complex, and controversial transformation issues. As we noted in our report, we believe that the Service's worsening financial situation and outlook intensify the need for Congress to act on meaningful postal reform and transformation legislation. Accordingly, we stated in our recently issued report that Congress should consider and promptly act on incremental legislative change that could help the Service deal with its financial situation.

We believe that comprehensive legislative change will be needed to address key unresolved transformation issues—some of which have not been fully addressed by proposed legislation or by the Service's Transformation Plan. One option is to use the legislative process to enact postal reform legislation, and some major proposals have been made in this area. Another option could be to create an independent commission that would address key unresolved issues and develop a comprehensive proposal for Congress to consider.

Meanwhile, the Service's growing financial problems call for continuing close congressional oversight of its current financial condition and progress in implementing its Transformation Plan. In this regard, it will be important to have greater transparency of the Service's financial information to minimize possible unexpected surprises and expectation gaps. It will also be important to have greater clarity about the time frames and financial impact associated with the actions outlined in the Transformation Plan that the Service plans to take immediately. To assist the Congress in its oversight responsibilities, we are monitoring the Service's financial condition and the implementation of its plan. Committed leadership and sustained attention in these areas will be important in order to achieve the results necessary for us to reassess our inclusion of the Postal Service's transformation efforts and long-term outlook on our High-Risk List.

Your strong support for the Service to develop a transformation plan has helped move the discussion forward, and this hearing is further highlighting the need for change. We look forward to working with the Congress in addressing this and other important government transformation issues. In many ways, the challenges facing the Service represent a microcosm of a range of challenges facing other federal agencies. I would be pleased to respond to any questions that you or other members of the subcommittee may have.

Contact and Acknowledgments

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Appendix I

Key Problems Identified by GAO and Actions in the Postal Service's Transformation Plan to Address Them

Table 2: Summary of Key Service Problems and Actions in the Service's Transformation Plan	Follow-up responsibility for actions and milestones
1. Net Income: The Service has difficulty generating positive net income, despite recent rate increases, and expects a large deficit in FY 2002.	
1.1 Replace the break-even requirement with a provision for a reasonable rate of return.	Postal Service, Congress
1.2 Increase the amount of funds in rate cases for capital purposes for new facilities.	Postal Service, PRC
2. Cost-cutting/productivity: Costs are increasing faster than revenues and are hard to cut. The Service has difficulty making and sustaining productivity increases.	
2.1 Deploy more automation (Postal Automated Redirection System, Automated Flat Sorting Machine (AFSM 100) and tray handing systems for AFSM 100 and 1000; low-cost tray sorters, next generation parcel sorting equipment—the parcel Singulate, Scan, Induction Unit and Automated Package Processing System).	Postal Service, milestones from 2002-2004
2.2 Increase throughput and reduce nonautomated letter mail stream through equipment modifications and customer incentives (FSM 1000 automated flats feeders and optical character readers; technology upgrades to improve address recognition and enhance feeder systems).	Postal Service, milestones 2002-2004
2.3 Develop more automation (e.g., Universal Tray System , automated delivery point sequencing equipment for flats, automation of processing of Business Reply Mail and Courtesy Reply Mail cards).	Postal Service; Universal Tray System in one site by end 2002
2.4 Move toward long-term vision of one bundle of mixed letters and flats for each delivery point called the Delivery Point Packaging after delivery point sequencing of flats mail is implemented.	Postal Service; one bundle: 4 years for R&D; flats-delivery point sequencing: pursue 32 month time table for development and selection
2.5 Deploy flats remote encoding system to consolidate flats keying systems and minimize idle time.	Postal Service, milestones from 2002-2003
2.6 Reduce tray and piece handlings and improve efficiency of postal operations by working with customers and the mailing industry to explore product redesign and worksharing options.	Postal Service; mailing industry
2.7 Improve delivery productivity through deployment/use of the Delivery Operations Information System to provide data to delivery supervisors; the Managed Service Points system to scan bar codes at the delivery unit and along the carrier's route of travel; the Delivery Performance Achievement and Recognition System to benchmark, set goals, and give recognition for both city and rural delivery; initiatives to improve rural delivery; and test optimizing city carrier routing and travel paths and the Segway Human Transporter.	Postal Service, milestones in 2002 and 2003
2.8 Modernize purchasing procedures by changing postal regulations.	Postal Service
2.9 Implement supply chain management. Consolidate purchases for better quality and lower costs (redesign purchasing organization into interdisciplinary commodity teams; reduce low-dollar value transactions; and forge stronger, more effective relations with key strategic suppliers).	Postal Service
2.10 Revise certain statutory requirements relating to the Service's supply chain management, such as the Service Contract Act and the Davis-Bacon Act, to reduce costs and administrative requirements not applicable to commercial businesses.	Postal Service, Congress
2.11 Reduce injury compensation costs by expanding the Preferred Provider Organization program throughout the Service, to reduce medical fees below what the Department of Labor's Office of Workers' Compensation Program (OWCP) allows, and identify duplicate payments that get through OWCP's system.	Postal Service, OWCP; milestones in 2002-2003
2.12 Reduce injury compensation costs by moving all Federal Employees' Compensation Act (FECA) recipients to FECA annuity at age 65. The FECA annuity would equate to the same costs as a normal retirement for all present and former Service employees over age 65 on OWCP compensation rolls.	Postal Service, Congress, Office of Management and Budget, OWCP; milestone: 2002-2003
2.13 Reduce injury compensation costs by encouraging OWCP to revise its regulations to allow direct contact with the treating physician by the employing agency (i.e., the Service).	Postal Service, OWCP; milestone: 2002-2003

Table 2: Summary of Key Service Problems and Actions in the Service's Transformation Plan	Follow-up responsibility for actions and milestones
2.14 Reduce injury compensation costs by developing joint strategies with OWCP, such as an accelerated private sector placement program that reduces time for private sector outplacement of injured Service employees from up to 2 years to less than 1 year. Create new internal positions to accommodate injured workers.	Postal Service, OWCP; milestone: 2002-2003
2.15 Reduce and deter criminal misuse of workers' compensation.	Postal Service
2.16 Address issues contributing to escalating FECA costs: Compensation rates are too generous; should be only one rate (66 2/3 percent); no waiting period before wage-loss compensation is paid.	Postal Service, Congress
2.17 Optimize the transportation and distribution networks: the Network Integration and Alignment initiative is designed to create a flexible logistics network to reduce the Service and customer costs, increase overall operational effectiveness, and improve consistency of service. Streamline and simplify the distribution network. Consolidate sorting facilities, eliminate excess resources, and determine facility roles and functions. Deploy Surface Air Management System and Surface Air Support System, develop transportation optimization planning and scheduling, develop transportation contract support system; and increase utilization of mail transport equipment.	Postal Service, milestones in 2002-2003
2.18 Increase retail/customer service productivity (operational standardization, continued automation of mail processing operations that occur in the back rooms of post offices), implement facility design changes where feasible to enable 24-hour access to critical products and services.	Postal Service, milestones in 2002-2004.
2.19 Expand access to postal services by moving simple transactions out of post offices (communicate information on alternative services (i.e., advertising), provide an on-line postage label application so packages can be dropped in a P.O. box, or handed to/picked up by carriers).	Postal Service; milestones: online postage label by fall 2002 mailing season
2.20 Create new low-cost retail alternatives. Expand self-service alternatives (kiosk services, such as ATMs, new technology for basic stamp purchases and mailing services, automated postage printers, automated postal center—enabling self-service purchase of stamps and mailing of packages).	Postal Service, milestones in 2002-2003
2.21 Improve performance management around best practices, including standardizing mail processing. Consolidate mail-processing activities and centralize or relocate these activities. Also conduct other labor reviews and standardize mail-processing operations, including those for Priority Mail operations. Implement complement planning, tracking, and management processes.	Postal Service, milestones in 2002-2003
2.22 Manage realty assets to maximize return by reducing costs related to properties for sale, short-term and development leasing, developmental added value properties, and other programs.	Postal Service
2.23 Achieve savings in international air transportation by deregulation to convey to the Service authority to competitively contract in the open market.	Postal Service, Congress
3. Safety/security: Expenditures and funding to enhance mail safety and security are uncertain. Safety and security needs exacerbate the Service's financial problems.	
3.1 Implement comprehensive plan for improving mail safety and security.	Postal Service, Congress (appropriations).
3.2 Enhance security across technology to avoid disruptions in critical operations and protect sensitive information from unauthorized disclosure or modification (education and training, certification process, contingency planning, intrusion protection, automated monitoring).	Postal Service milestones in 2002-2007, annually, and ongoing
3.3 Ensure safe, secure, and drug-free work environment (reduce and deter employee-on-employee assaults and credible threats, robberies, illegal drugs).	Postal Service
3.4 Provide for the security of the mail and postal products, services, and assets (reduce and deter mail theft, related identify theft and takeovers, criminal attacks on postal products, services, and assets).	Postal Service
3.5 Combat crimes using the postal system (e.g., mail fraud, and prohibited, illegal, and dangerous mailings).	Postal Service
3.6 Ensure the Service maintains its trusted brand and provides top-rate privacy protection (standardize privacy policies and procedures, streamline compliance procedures, work with internal and external groups to build privacy into data-oriented initiatives).	Postal Service and external groups
4. Cash flow: Cash-flow pressures continue because of cost/revenue trends.	
4.1 Improve cash flow by generating net income, cost-cutting, moderate rate increase (not until 2004), and planning capital outlays so that they do not exceed cash flow.	Postal Service

Table 2: Summary of Key Service Problems and Actions in the Service's Transformation Plan	Follow-up responsibility for actions and milestones
5. Debt: The Service has no debt reduction plan as its debt nears the $15 billion limit.	
5.1 Reduce debt and remain within the current statutory debt limits. This strategy will be modified as necessary to ensure that the Service preserves its ability to meet all of its cash obligations. To stabilize and reduce debt, the Service will need to recover prior years' losses and plan capital cash outlays so that they do not exceed cash flow. Also, the Service cannot simultaneously generate net losses and reduce its borrowings.	Postal Service
5.2 Manage the Service's mix of short- and long-term debt to lower interest expense over time.	Postal Service
6. Basic Business Model: Mail volumes have declined in major revenue producing areas. The Service's business model, which relies on rising mail volumes to cover rising costs, is not sustainable and needs a comprehensive transformation.	
6.1 Transform the Service into a commercial government enterprise (model recommended by the Service).	Congress
6.2 Enhance the value of the mail through technology (identify/track mail pieces through Confirm).	Postal Service, PRC milestones: Postal Service filed for Confirm classification on April 24, 2002)
6.3 Improve the access, speed, and reliability of accountable mail services (Internet access to delivery time and date of Certified Mail and Return Receipt; other product enhancements).	Postal Service; milestones in 2002 (e.g., Internet access to Certified Mail, Return Receipt)
6.4 Design rates and mail preparation to match customer needs (simplify rate structure, preparation and acceptance requirements for moderate users of bulk mail, and for mailing books and parcels).	Postal Service, PRC, mailers; product redesign to take about 3 years, implementation by summer of 2004
6.5 Position mail as a key communications medium and as a customer relationship management tool (customize postal products to enable small- and medium- sized business customers to leverage mail for promotion).	Postal Service, milestones: ongoing
6.6 Enhance package services (acceptance scanning of return parcels, new parcel categories—reduce number of categories, rate structures, and confusing requirements) by providing, merchandise return, new mail categories, and an on-line postage label application.	Postal Service; milestones same as Product Redesign (implementation by summer 2004) except for labels by fall 2002 mailing season
6.7 Promote greater ease-of-use to improve customer satisfaction and sales. Transform the Domestic Mail Manual and make rules and regulations more market-responsive.	Postal Service; milestones: none
6.8 Develop a corporate-based pricing plan and a set of strategies to develop market-based pricing. Retain and increase international market share.	Postal Service; milestones: none
7. Rates Increases: Rates for certain categories of mail are rising faster than inflation and more increases possible.	
7.1 No rate increases are planned until calendar year 2004.	Postal Service
7.2 Next rate increase is planned to be a moderate and negotiated settlement.	Postal Service, mailers, competitors, PRC
8. Infrastructure/capital investment: Changes to infrastructure are limited by legal requirements and practical constraints. Further, the capital program freeze is unsustainable.	
8.1 Lift the self-imposed moratorium on post office closings and consolidations.	Postal Service, done by PMG in April 2002
8.2 Close unnecessary contract postal units.	Postal Service
8.3 Implement retail access strategies to ensure that customers retain adequate access to products and services.	Postal Service
8.4 Work with the PRC to streamline the post office closing process to minimize turnaround time.	Postal Service and PRC
8.5 Repeal statutory administrative notice procedures mandated for closing post offices (see 39 U.S.C. 404(b)), or replace them with more flexible procedures.	Postal Service, Congress
8.6 Eliminate appropriations language that discourages post office closings and freezes service levels at the 1983 level.	Congress

Table 2: Summary of Key Service Problems and Actions in the Service's Transformation Plan	Follow-up responsibility for actions and milestones
8.7 Optimize the retail network (through development of a network database, baseline the current retail network; accommodate retail growth demand via a logical system that matches appropriate channel with demonstrated marketplace needs; replace redundant post offices, stations, and branches that do not provide appropriate value with alternative retail channels).	Postal Service and Congress; milestones in 2002 for completing the network database
8.8 Upgrade and reengineer the computing infrastructure to support current and new business requirements, as well as to enable the Service to become more efficient and to reduce operating costs. (Upgrade distributed, midrange, and mainframe computing infrastructure and implement technical and corporate shared services initiatives.)	Postal Service, milestones in 2002-2009 and annually
8.9 Provide universal computing connectivity (consolidate voice, data, and video network and implement wireless technology initiative).	Postal Service, milestones in 2002-2008
9. Human capital: The Service faces difficult human capital challenges, including workforce planning and realignment, performance management, compensation and benefit issues, and labor-management relations.	
9.1 Retain employees with skills critical to the Service's success. (Study retention trends and develop plans for retention and recruitment incentives to allow the Service to compete for talent.)	Postal Service, milestones in 2003
9.2 Concentrate recruitment efforts on bringing talent, skills, and experience from within and from outside the Service to address potential loss of Service leadership. (Implement Associate Supervisor Program and Management and Professional Specialist Intern programs, use third parties for marketing/attracting candidates to specialized skill positions, deploy an automated screening process, pilot centralize recruitment structures for hard-to-fill bargaining and nonbargaining positions nationwide, and use Web technology to enhance recruitment and hiring processes.)	Postal Service, milestones in 2002-2004
9.3 Remove statutory salary cap for Service employees to help recruit and retain selected managers, executives, and officers.	Postal Service, Congress
9.4 Utilize succession planning to identify, develop, and select current and future leaders. (Continue executive development programs; hold officers and executives accountable for having/implementing individual development plans for successors.)	Postal Service, milestones in 2002-2003
9.5 Ensure that a dynamic training curriculum is available to develop a pool of talent to fill leadership positions. (Maximize available training and development programs to have a pool of potential successors at all levels. Establish defined career path for supervisors and managers to facilitate succession at low-level to mid-level positions. Implement more technology-based training. Develop learning management system to coordinate administration, scheduling, tracking, assessment, and testing of learners.)	Postal Service, milestones in 2002-2006
9.6 Create a performance-based pay system. Redesign performance-based pay systems and assessment systems from executives to front line supervisors and EAS grade-level 15. A new pay system will place a greater focus on rewarding individual rather than group achievement. The Service will consult with postal management associations and then phase in the new performance assessment system.	Postal Service, management associations; milestones in 2002-2004
9.7 Build a highly effective and motivated workforce. Use existing programs and measures to hold district, area, and headquarters leadership accountable for the following activities: improving percentage of favorable responses to Voice of the Employee survey, identifying troubled worksites and develop effective plans to correct problems, supporting District Joint Employee Assistance Program Advisory Committee, supporting Diversity's continuous education initiatives, maintaining trained Threat Assessment Team and properly prepared Crisis Management Team, providing violence awareness and sexual harassment training according to policy. Organize the most predictive workplace data for use by districts and areas to create proactive interventions: Form predictive profiles to allow the Service to become more proactive in dealing with potential workplace environment issues.	Postal Service, milestones in 2002-2004
9.8 Improve workforce planning. Move to an integrated workforce planning process with a single function responsible for reporting trends and issues. Fully utilize the provisions of collective bargaining agreements to reposition the workforce as needed to meet customer demands and operational requirements. Execute reduction-in-force avoidance strategies, including voluntary early retirement offerings and internal movement of employees. Consider reduction-in-force alternatives (voluntary reduced hours, retirement incentives, layoffs, voluntary sabbaticals). Seek cost-efficient ways to move people from positions that are no longer necessary. Modify applicable placement, training, and right-sizing processes.	Postal Service, milestones in 2002-2005

Table 2: Summary of Key Service Problems and Actions in the Service's Transformation Plan	Follow-up responsibility for actions and milestones
9.9 Expand shared services in accounting and human resources (i.e., sharing technology, people, and other resources within and across administrative functions to reduce costs and improve the quality of administrative services).	Postal Service, milestones in 2002-2004
9.10 Explore outsourcing/implement outsourcing initiatives with potential to increase service/quality levels, better utilize resources, reduce costs, and allow greater emphasis on the Service's core business. Labor Relations is pursuing the establishment of an Employee Stock Ownership Plan for Equal Employment Opportunity investigative work. The Service will evaluate cost savings derived from outsourcing and Employee Stock Ownership Plan initiatives and use existing quality and performance measures to determine if these are improved by the initiatives.	Postal Service
9.11 Meet with craft union leaders to seek agreement on modifications to the current interest arbitration process to include mediation by the next cycle of negotiations.	Postal Service, craft union leaders; milestones in 2002-2003
9.12 Replace the statutory mediation and binding arbitration provisions with a process similar to the Railway Labor Act, including a mandated mediation process (a single mediator selected by the secretary of labor, who by law would be of national reputation and professional stature and a member of the National Academy of Arbitrators) and strike and lockout provisions.	Postal Service, Congress
9.13 Improve labor-management relations. (Expand various joint employee involvement and quality of work-life initiatives with labor unions. Develop and provide contract administration and labor/management training to management and bargaining unit employees. Continue to have the Service's leadership, employee unions, and management associations participate in joint initiatives. Improve ability to resolve issues and disputes, and decrease grievance activity by developing joint handbooks and manuals. Develop and expand alternatives to traditional discipline and dispute resolution methods, including further development and refinement of the REDRESS® program and the use of labor and management Dispute Resolution Teams.)	Postal Service, labor unions, management associations
10. Liabilities: Liabilities exceed assets, and long-term retirement liabilities are growing.	
10.1 Increase income generation and minimize the increase in deferred retirement costs by allowing postal retirement fund assets to be invested in other than federal securities at higher rates of return. This would involve investment of postal-related Civil Service Retirement System and Federal Employees Retirement System retirement fund assets currently managed by the Office of Personnel Management.	Postal Service, Congress
11. Transparency and reporting: Greater transparency is needed regarding the Service's financial operating results and projections.	
11.1 Eliminate the postal fiscal year and use only the government fiscal year for internal and external reporting. Convert the Service's reporting (financial and all other) from the existing accounting period format (i.e., 4-week accounting periods) to a calendar month format, with monthly and quarterly reporting.	Postal Service, milestones from Jan. 2002 to September 2003
11.2 Publish quarterly financial reports for the first, second, and third quarters.	Postal Service
12. Accountability: Limited mechanisms are in place to promote accountability.	
12.1 Redesign the performance-based pay system.	Postal Service
13. Incentives: Legal framework (monopoly, break-even requirement, rate-setting) limit incentives to cut/restrain costs or to innovate.	
13.1 Replace the break-even requirement with a provision for a reasonable rate of return (also listed as 1.1 above).	Postal Service, Congress
13.2 Replace cost-of-service rate regulation (see 15 below).	Congress
14. Rate-setting process: The Service's rate-setting process is lengthy, adversarial and provides limited incentives to control costs.	
14.1 Work with the PRC to improve the rate-setting process and change the rate and classification structure. Initiatives: phased rate changes, operationally targeted experiments, major reclassification effort, segmentation for major products, negotiated service agreements, volume discounts. Initiatives to be considered: contract/customized pricing, bundle pricing for multiple products/services, seasonal discounts and premiums. Improve rate-setting process by streamlining process to allow reasonable pricing changes without extensive regulatory hearings.	Postal Service, PRC, mailing community; the Service plans a "summit" with PRC and other stakeholders on changes to ratemaking and classification processes
14.2 Review the statutory rate-setting process to identify potential changes for improvement. For example, replace the existing statutory system with some form of incentive regulation giving the Service pricing flexibility for competitive products, subject to rules to protect the market from anticompetitive Service activities.	Postal Service, PRC, Congress

Table 2: Summary of Key Service Problems and Actions in the Service's Transformation Plan	Follow-up responsibility for actions and milestones
15. Universal service mission/role: The Service has not defined what universal postal services are needed by the American people in the 21st century and the Service's role in providing such services.	
15.1 Obtain greater flexibility to adjust the number of delivery days.	Postal Service, Congress
15.2 Obtain greater statutory and regulatory flexibility to redefine universal retail postal service, including standards for access and levels of service.	Postal Service, Congress, PRC
16. Governance: The Service's business model and governance structure are problematic and need to be reassessed as part of transformation.	
16.1 The Service's proposed commercial government enterprise model refocuses the board of governors on fiduciary duties.	Postal Service, Congress

Source: Postal Service and GAO-02-355.

Appendix II

Postal Service Mail Volume and Revenue Information

Table 3: Mail Volume by Category for the First 2 Quarters of Fiscal Year 2002 Compared with the Same Period in Fiscal Year 2001

Pieces in thousands

	FY 2002			FY 2001			Percent
Category	**Q1**	**Q2**	**Total**	**Q1**	**Q2**	**Total**	**change**
First Class Mail	23,312,681	25,015,392	48,328,073	23,862,319	25,460,191	49,322,510	-2.0
Priority Mail	228,615	261,309	489,923	275,249	298,492	573,741	-14.6
Express Mail	13,382	14,888	28,270	15,901	16,488	32,389	-12.7
Mailgrams	895	281	1,176	870	875	1,745	-32.6
Periodicals	2,290,100	2,249,606	4,539,706	2,323,486	2,354,447	4,677,932	-3.0
Standard Mail (primarily advertising)	22,103,683	18,728,591	40,832,274	24,295,808	19,719,809	44,015,617	-7.2
Package Services	247,632	267,714	515,346	254,641	263,588	518,228	-0.6
International Mail	215,122	241,579	456,701	271,854	306,055	577,909	-21.0
U.S. Postal Service Mail	126,372	86,079	212,451	87,826	81,626	169,452	25.4
Free Mail for the Blind and Handicapped	12,942	12,801	25,743	10,898	8,514	19,412	32.6
Total	**48,551,424**	**46,878,239**	**95,429,663**	**51,398,851**	**48,510,084**	**99,908,936**	**-4.5**

Source: Postal Service.

Table 4: Mail Revenue by Category for the First 2 Quarters of Fiscal Year 2002 Compared with the Same Period in Fiscal Year 2001

Dollars in thousands

	FY 2002			FY 2001			Percent
Category/service	**Q1**	**Q2**	**Total**	**Q1**	**Q2**	**Total**	**change**
First-Class Mail	$8,186,087	$8,719,882	$16,905,969	$8,173,027	$8,702,737	$16,875,764	0.2
Priority Mail	1,049,492	1,257,527	2,307,019	1,092,471	1,328,586	2,421,057	-4.7
Express Mail	194,463	220,669	415,133	222,716	240,212	462,929	-10.3
Mailgrams	426	138	565	331	347	678	-16.7
Periodicals	519,301	485,883	1,005,183	505,868	498,138	1,004,006	0.1
Standard Mail (primarily advertising)	3,979,001	3,337,462	7,316,463	4,053,900	3,401,326	7,455,226	-1.9
Package Services	488,206	542,798	1,031,004	451,797	493,031	944,828	9.1
International Mail	370,041	420,671	790,711	408,162	462,045	870,207	-9.1
Services	506,659	535,025	1,041,683	422,604	452,559	875,163	19.0
Other revenue[a]	73,296	105,442	178,738	95,390	100,895	196,285	9.8
Total	**$15,366,971**	**$15,625,498**	**$30,992,468**	**$15,426,266**	**$15,679,876**	**$31,106,143**	**-0.4**

[a]Other revenue includes investment income, reimbursement revenue, revenue foregone, advertising, e-commerce initiatives, retail initiatives, and miscellaneous services such as passport services.

Note: Totals may not add due to rounding.

Source: Postal Service.

Appendix III

Postal Service Performance Scores

Table 5: Overnight First-Class Mail				
Percent on-time delivery				
Year	Q1	Q2	Q3	Q4
1993	83.29%	83.01%	84.30%	83.59%
1994	83.53	78.80	82.75	82.56
1995	84.09	84.52	86.82	87.23
1996	87.76	87.31	90.41	91.21
1997	90.77	90.75	92.15	92.35
1998	92.86	92.66	93.51	93.02
1999	92.78	93.15	93.54	93.74
2000	93.43	93.53	94.44	93.89
2001	93.02	92.80	94.06	93.96
2002	92.93	93.46	N/A	N/A

Table 6: Two-Day First-Class Mail				
Percent on-time delivery				
Year	Q1	Q2	Q3	Q4
1993	77.76%	74.73%	78.27%	78.10%
1994	76.52	66.72	72.37	74.36
1995	75.53	75.04	79.07	80.10
1996	79.49	75.54	80.04	80.25
1997	75.90	71.74	78.59	78.58
1998	78.88	78.70	86.06	87.66
1999	86.47	83.36	86.89	88.37
2000	86.41	83.60	87.02	87.87
2001	85.70	81.15	84.77	86.08
2002	82.06	82.24	N/A	N/A

Table 7: Three-Day First-Class Mail				
Percent on-time delivery				
Year	Q1	Q2	Q3	Q4
1993	81.92%	77.16%	80.18%	81.62%
1994	79.24	65.44	76.84	78.55
1995	80.16	75.52	82.19	82.72
1996	82.24	70.93	82.44	82.82
1997	79.01	70.03	80.20	80.14
1998	80.49	74.24	83.68	86.44
1999	86.69	79.18	86.87	88.12
2000	85.59	78.87	85.60	86.38
2001	83.77	73.76	81.00	83.18
2002	72.35	73.51	N/A	N/A

Note: N/A = No data available for Q3 and Q4.
Source: Postal Service.

(543022)

GOVERNMENTAL AFFAIRS SUBCOMMITTEE
ON INTERNATIONAL SECURITY, PROLIFERATION
AND FEDERAL SERVICES HEARING ON
THE POSTAL SERVICE IN THE 21ST CENTURY: THE USPS TRANSFORMATION PLAN
MAY 13, 2002

QUESTIONS FOR POSTMASTER GENERAL JOHN POTTER
FROM CHAIRMAN DANIEL AKAKA

Human Resources

1. The Transformation Plan indicates that many of the USPS supervisors and managers will become eligible for retirement in the next four to five years. You indicate that USPS will introduce a Management Intern Program and a Professional Specialist Program to address recruitment of personnel with critical skills in the areas of technology and management. Would you explain the strategies that will be used to recruit employees into these programs, and would you detail your plans for dealing with these problems in the short term? What other succession plans are being considered?

The Management Intern Program (MIP) is based on the successful Office of Personnel Management's (OPM) Presidential Management Intern Program. Working with OPM, the Postal Service developed a recruitment and assessment process for internal and external candidates. To apply, applicants must have received a master's degree in business, engineering, or management (especially transportation, logistics, or financial management) from an accredited graduate program by May 2002. Qualified applicants participate in a one-day assessment process to evaluate their problem-solving, communications, interpersonal, leadership, and teambuilding skills. The assessment includes an individual presentation, a group discussion, and a writing exercise. In June of this year, the Postal Service hired 22 Management Interns. Plans are being formalized to begin the recruitment process in October for FY 2003, and subsequent years.

The Professional Specialist Program is designed to address technological and management needs in critical skill areas at Headquarters, and Headquarters field offices. The functional areas with the critical skill need will identify key positions and corresponding two year developmental programs for the designated positions. Corporate Personnel Management (CPM) will assist with the recruitment and selection of both internal and external candidates. CPM is now in the process of advertising and recruiting for the initial positions, and will complete the selection process in September. This program will be ongoing with recruitment beginning in October of each year.

The Postal Service has a variety of other succession plans underway, including the Sloan Program, the Executive Exchange Program, and Mentoring. These programs provide leadership and management training to help prepare employees for future executive positions.

2. Will the Postal Service use the impending retirements to restructure its workforce and reduce the number of employees? If so, how will the USPS plan and manage this restructuring?

While retirements may yield a reduced number of employees, it is critical that sufficient resources are available to support the core mission of processing and delivering the mail. As in the past, efforts to reduce personnel costs will be balanced with our organizational requirements. Postal Service restructuring efforts will continue to use a systematic approach to review the work that is being performed, to determine whether that work should continue to be performed, and to determine if there are better ways to perform the work that remains.

3. The Service has experienced long-standing labor management problems that have, among other things, hindered productivity improvement efforts. To what extend has the Postal Service worked with the unions to develop innovative productivity improvements for mail processing and delivery operations, and what successes have been realized?

We believe that continuing disputes over work rules have had a negative impact on productivity both in delivery and mail processing. In an effort to improve the workplace environment and reduce the number of disputes, the Postal Service has developed a joint contract interpretation manual with the National Association of Letter Carriers (NALC), and is in the process of finalizing a manual with the American Postal Workers Union (APWU) and the National Postal Mail Handlers Union (NPMHU). This initiative has been complemented with new jointly developed grievance/arbitration procedures with the NALC that produce faster and more responsive resolutions to workplace disputes at the local level.

In addition, the Postal Service continues to support Employee Involvement/Quality of Work Life (QWL) programs with both the National Rural Letter Carriers Association (NRLCA) and the NPMHU. Recently, mail processing successes from the NPMHU' QWL teams were celebrated at a joint conference.

4. The Postal Service has noted recent progress in reducing the number of outstanding grievances, but many thousands of these grievances remain to be settled. What steps is the USPS taking to make further progress in this area?

As noted in question three, the Postal Service has developed the USPS-NALC Joint Contract Administration Manual (JCAM). First published in June of 1998, the JCAM is about to undergo its fourth update. Each updated edition provides more information to guide field officials in applying the national collective bargaining agreement. This reference tool, along with the new, nationally implemented Dispute Resolution Procedure (DRP), has reduced the number of grievances appealed to arbitration and has reduced the backlog of grievances pending arbitration by 50 percent over four years.

A similar effort to publish a joint contract reference manual with the NPMHU is nearly complete, and the APWU is currently reviewing the Postal Service's first draft of such a reference manual for that union.

In addition, the Postal Service continues to engage the NALC, APWU, and NPMHU in periodic reviews of the existing arbitration backlog in an effort to resolve those cases that can be resolved prior to arbitration.

5. The USPS reported taking steps to address long-standing problems associated with a management style that has hindered strong labor relations. What is the Postal Service doing in this regard?

We believe education is the key to addressing problems associated with management style. The Postal Service has implemented the Associate Supervisor Program (ASP), a sixteen-week course for initial level supervisors, to provide managers with a comprehensive training program. ASP is a combination of classroom and on-the-job experiences designed to provide trainees with the critical knowledge and skills necessary to lead and succeed. An important component of the training program addresses human relations skills.

Additionally, the Postal Service has implemented the "Troubled Site Process." This is a joint process with the unions to identify problem sites with the goal of identifying and resolving disputes through communication and consultation at the local level.

6. Would the proposed Commercial Government Enterprise's pension fund and health plan be part of the federal system? What would happen to current employees' retirement benefits? Who would guarantee the pensions of existing pensioners, current employees, and future employee?

The Commercial Government Enterprise (CGE) concept has been advanced as a plausible model for the future. At this time, specific proposals concerning pensions and retirements have not been developed.

It should be noted that the Postal Service has a liability to OPM to fund: (1) the Civil Service Retirement System (CSRS) for the retirement liabilities created by general increases granted by Postal Service management; and (2) cost-of-living (COLA) increases granted to postal retirees by the federal government. These funding requirements are determined by OPM, which is responsible for actual payment of pension benefits to all federal retirees.

Of course, the Postal Service is also responsible for the dynamic funding of the Federal Employees' Retirement System (FERS).

Operations/Facilities

7. The Transformation Plan recognizes a need for regulatory oversight of the Postal Service because of its public service role. The Plan notes that the Board of Governors may change to focus more on financial oversight. Can you provide your vision of how the functions of the Board and the Postal Rate Commission would change from their present structures? Would a Commercial Government Enterprise Board be presidentially-appointed? How do you envision the Board's role, and what qualifications would be required for Board members?

In compliance with the U.S. Constitution, the Postal Service must be under the direction of officials appointed by the President while it continues to be part of the executive branch of the United States government. In a commercial environment, with a transformed but still government postal entity intended to seek a return on the government's investment and to accumulate retained earnings for the long-term support and viability of the system, the Board would need to function somewhat more like the Boards of other commercial entities. In the Transformation Plan, we described the broad outlines of how the Postal Service might be structured as a commercial government enterprise, without attempting to prescribe particular divisions of authority and responsibility in detail. One might conceive a range of potential solutions that could serve the broad aims reflected in the Plan. Given the diversity of interests in the postal community, we do not think that the Postal Service can expect to impose on the process a specific detailed proposal resolving all of the issues that may arise.

8. The Postal Service is studying whether to close or consolidate some facilities. What is under consideration, what criteria will be used, how will you ensure transparency in the process, and how do think facility consolidation would affect the Service's future capital investment needs? Additionally, how are you involving union and non-union employees in this process?

In our mission to provide universal mail service, the Postal Service must manage one of the largest and most complex logistics networks in the world. As the economy and demographics of the United States have changed, our networks have evolved in response to the needs of the nation. Network complexities are inherent in a system that provides service to a multitude of mail classes and shapes, which are transported between 932 different 3-digit ZIP Code areas. Our existing infrastructure of 400 plus processing plants inhibits our ability to quickly respond to changing business requirements, customer demands, and national crises.

The Postal Service's present financial situation, coupled with rapid technological advances in supply chain management technology, makes this the ideal time to initiate a comprehensive redesign of our distribution and transportation networks. To this end, the Postal Service has initiated a network optimization effort with a charter to create a flexible logistics network that reduces both the Postal Service's costs and the customers' costs, increases overall operational effectiveness, and improves consistency of service.

The Network Integration and Alignment (NIA) initiative is a scientific, data-driven approach to provide us with the analytical means to drive the necessary redesign of our existing network and provide rapid response capability. A team of Postal Service operations experts, mailing industry representatives, supply chain management professionals, and world-renowned network optimization experts from industry and academia are working to produce a set of network optimization and simulation models that will objectively analyze costs, capacities, and volume flows for each mail processing facility. These models will also determine which facilities remain viable and necessary within the future infrastructure and what distribution and transportation roles will be performed by those facilities that remain as parts of an optimal, fully integrated network.

As part of our transformation strategies we intend to work closely with our labor unions and other key stakeholders, providing a clear view of what we want to accomplish for our organization. We are promoting a spirit of cooperation as we jointly examine ways to improve not only our business effectiveness and operational efficiency, but our relationships with the labor unions and management associations as well. This will allow us to react quickly to changes in customer demand and improve operational efficiency.

Decision criteria to be used for facility consolidation/expansion:

1. **Processing costs that leverage demonstrated economies of scale and scope.**

2. **Transportation costs as further defined by mode selection criteria.**

3. **Ability to meet service requirements as defined within time bands that correspond to allowable transport components within the operating plan.**

4. **Capacity constraints dictated by floor space requirements and time windows to achieve necessary throughputs.**

5. **Facility opening, closing, expanding, and altering costs.**

6. **Each individual facility's ability to contribute toward total network optimization as defined by total cost minimization.**

No weights are provided for any one factor over another. The feasibility of each facility being able to perform any given role is determined; then, costs are associated with the facility performing each given role based upon that facility's demonstrated performance. Network optimization chooses the least cost solution for the total network.

Finances/Management

9. As you know, without robust business management information technologies a business cannot accurately track costs. The Transformation Plan discusses the need for pricing flexibilities, however, the Plan appropriately notes "that the Postal Service would be unable to take full advantage of increased pricing flexibilities unless good product cost data can be extracted and used in a product-based costing system." Wouldn't it be useful to develop and employ data systems of this type, in advance of any transformation plan, and what steps are you taking to do this?

The Postal Service's current costing systems were designed to meet both management needs for timely information about the costs of providing products and the reporting requirements of the current statutory pricing system. It may be useful to begin modifications to the costing systems to enable Postal Service management to have information that is timelier than current systems, and refined enough to support a more flexible approach to pricing. But we need to be careful that we do not undertake wholesale changes to the costing systems without a clear understanding of what capabilities are needed. While we have begun to identify the types of data we will need to move forward, developing extensive new cost data systems without an understanding of what capabilities

we need would only waste scarce Postal Service resources. The process of identifying new costing data that will be needed to implement a more flexible approach to pricing is one element of the Corporate Pricing Plan that the Postal Service is currently developing.

10. In reviewing the Transformation Plan, I noted that you are proposing to save $5 billion dollars between the years 2002 and 2006. And yet, the Postal Service is projecting a $1.5 billion loss for this current fiscal year and reducing the workforce by 20,000 employees. The projected loss will result in the USPS debt rising to $12.9 billion, which is only $2.1 billion below the statutory debt limit. What are you projecting as your net income during the period next four years, and do you expect to reach or exceed the debt limit during this time frame?

Although it is premature to project specific net income goals, we believe, with renewed volume growth and absent additional extraordinary events, that the Postal Service should be able to operate within its statutory debt limit. The $12.9 billion debt projection was made at the beginning of this fiscal year and will be reviewed prior to year end. The freeze on the facilities portion of the Postal Service's capital program and the Governors' directive that increases in debt be minimized, have been effective in helping to control debt.

11. The Transformation Plan looks toward a Commercial Government Enterprise to raise capital without borrowing. Has the Postal Service considered incorporating the need for more capital spending in its rate cases and asking for higher rates before the Postal Rate Commission?

Yes. The Postal Service will pursue ways to include cost increases in the revenue requirement in future rate cases for new facilities to serve the expanding delivery network. However, the goal of incorporating the need for more capital spending in rate cases would have to be balanced against the needs of current customers and the ability to meet future needs for efficient service.

12. Under the Commercial Government Enterprise (CGE), approach would the U.S. government be explicitly or implicitly liable for the CGE's liabilities?

The Government is not explicitly liable for the Postal Service's liabilities now. Presumably, that would not change under the CGE approach. As we indicated in the Transformation Plan, unless the postal system can continue to be financially viable while meeting its public service obligations, the Congress could eventually find it necessary to choose between continuing those obligations or providing some of the funding to support them.

13. The Transformation Plan notes that privatization of the Postal Service was rejected because it would be inappropriate to focus on profit. However, aren't retained earnings the same as profit and would be the focus for a Commercial Government Enterprise? Do you believe there should be a limit placed on the amount of CGE profit?

Generally speaking, a company that generates a profit can either pay it out to shareholders as a cash dividend, or retain the earnings and reinvest them in the business. The Postal Service does not have shareholders, so any surplus would be retained by the Postal Service for use in funding its operations and other obligations. We do not consider a profit limitation to be necessary. We believe that the rising costs of serving a continuously expanding delivery network combined with existing and emerging competitive pressures will place a natural brake on the growth of profits. Under the CGE concept, retained earnings are a source of funds for the capital costs associated with the expanding delivery network. Retained earnings will also help to decrease outstanding debt and to fund investments in technology.

14. You cite the Commercial Government Enterprise model as favored by liberalized foreign posts. What is the record of these liberalizations in terms of rates, efficiencies, and unfair cross-subsidization from monopoly rates?

While many foreign posts have undergone significant change in the last decade, it is very difficult to be specific about the results of the liberalization of these posts because of differing legal and regulatory frameworks across different countries. However, we can make several general observations about foreign postal liberalization. Generally, a process has been established to allow competitive entry in non-monopoly markets. Service standards have often improved and measures of service performance are more frequently available to customers. Many liberalized foreign posts have begun offering non-traditional products and services such as electronic transmission of messages and data and retail banking so that they may better use their retail assets.

Generally, foreign post liberalization has resulted in retention of a "protected" sector, which typically includes letter mail weighing less than a specified number of grams. The pricing goal in many foreign regulatory regimes is to maintain reasonable rates within the protected sector; that is, to ensure that customers with few alternatives do not pay excessive postage rates. This policy goal would tend to limit the potential for cross-subsidization of non-monopoly products. However, unlike pricing for Postal Service products which is carefully reviewed by both the Postal Service and the Postal Rate Commission (PRC), the detailed examination of prices and costs for some foreign postal administrations often is not available to permit a determination of whether cross-subsidization exists or not.

Ratemaking/New Products

15. The Transformation Plan and the upcoming summit with the Postal Rate Commission indicate an interest in creating more streamlined rate processes. Why hasn't the USPS done that before? Why did the USPS not follow-up on a 1992 task force report that suggested a number of changes in procedure?

Several of the ideas discussed in the 1992 task force report have produced results. For example, the current PRC experimental and market test rules which allow expedition in smaller cases are an outgrowth of this report. However, some other proposals, such as the apparent proposal for phased rates, would likely have led to more rate filings not fewer.

The recent settlement of the Docket No. R2001-1 omnibus rate case is the most visible example of the Postal Service's and the PRC's efforts to streamline rate cases. While this settlement was driven by unprecedented circumstances, it also demonstrated that a non-litigated settlement can occur within an omnibus rate case. The Postal Service will make every effort to work within the PRC's rules to build on this success. In addition, the Postal Service has worked successfully with the Commission, customers and other interested parties in a number of small classification cases to reach settlement agreements that resolve issues without extensive litigation.

At the same time, it must be noted that the settlement was not achieved unilaterally by the Postal Service. Instead, it depended upon the continued encouragement of the PRC and the willingness of all the affected parties to work together. Currently, the Postal Service is bound by the PRC's rules which are predicated on the need to provide a fair hearing for all concerned parties. We hope to cooperate with the PRC to identify which of these rules are needed to preserve due process rights and which are outdated and need revision.

However, the statutory rate-making process itself as contained in Title 39 may not provide the pricing flexibility the Postal Service needs. The Postal Service hopes to move forward in the current, cooperative atmosphere and work to develop a regulatory framework that best meets the needs of customers, the American public and the Postal Service.

16. The Transformation Plan states that under the Commercial Government Enterprise approach the Postal Service will increase its offering of new retail products. Would you please specify what these retail products will be, and would you explain the metrics or strategies that would be employed to demonstrate how much new products and services will cost in relation to how much revenue they will net? As new products are considered and developed, will USPS consult with potential competitors, particularly small businesses, as to the effect on them of such competition, and lastly, will the expansion of USPS services require a greater advertising budget or campaign?

In the Transformation Plan, we stated that new retail services would be built around the Postal Service's core mission and unique capabilities, and will be provided to add value to customer visits and increase revenue to the Postal Service. We are concentrating on two specific retail categories, both described in the plan: complementary retail products and retail services provided on behalf of government and other partners. A complementary product is merchandise that directly complements our core business, including packaging and mailing supplies, and stamp-related products. An example of a service offered on behalf of a partner is the acceptance of passport applications, offered in partnership with the Department of State.

Regarding metrics used to evaluate retail products, all retail products are measured on a profit and loss basis, which is a practice that we plan to continue. To calculate net returns, gross revenues are reduced by all direct and indirect expenses. Types of expense may vary by type of product or service, but generally they include wholesale, inventory, packaging, and distribution costs (for physical products); systems development and support; transaction expense; advertising; and overhead. Strategically, a potential new retail product is evaluated primarily on the degree to which it addresses the needs of postal retail customers. Other considerations include the degree to which it can be operated and supported by our field managers and service associates, and our ability to integrate it into our operating and systems environments.

Our purpose for developing new or improved retail products and services is to improve the convenience and value of customers visiting a post office. Retail products must generate revenue sufficient to cover all costs and provide a contribution to the Postal Service overhead.

Almost every product offered by the Postal Service – including basic mail services – has competition in some form. However, our reason for offering any new service at retail is to improve the experience for our existing customers. We do not offer retail services to take customers away from retail competitors. We do not routinely check with all potential competitors before considering any service. It would often not be feasible in some cases, and in other cases it may inappropriate or anti-competitive (for example, to discuss price). However, we

are very sensitive to the potential impact that our services may have on other providers, and we consider that impact, along with other factors, in our planning process.

It may be appropriate to use paid advertising to inform customers about the availability of new or improved products and services, or improvements in access to those services. As with any expense related to a particular retail product, we would make this decision based on the expected financial return of that advertising. As a matter of course, we would always first attempt to use free communications channels or relatively low cost marketing tools (e.g., point of purchase displays) before proposing to use media or other advertising.

17. What can be done to allow for the development of a privatized government entity while still protecting a level playing field for the private market?

While more commercial in outlook and approach, a Commercial Government Enterprise (CGE) would still be under government direction and oversight; private competitors are not. This difference assures that the public interest is represented. In addition, the Transformation Plan recognizes that, for a postal system retaining monopoly protection, some form of regulation would be appropriate. The plan also contemplates that antitrust and fair competition rules might be applied as more competitive postal services are deregulated.

18. As the Postal Service begins its transformation, do you believe there should be any limits on the lines of business the USPS could pursue if an activity might lead to added revenues? If so, what remedies do you believe should be available to a competitor?

The Postal Service does not intend to enter into any lines of business that diverge significantly from its core mission of transmitting payments, messages and correspondence for the American public. However, the Postal Service is very reluctant to advocate any specific statutory restrictions; as we have found with the Postal Reorganization Act of 1970, well-intentioned – and mutually agreed upon – restrictions may become unsustainable in the future. Newer technologies may be developed that will allow citizens to better communicate in the future.

19. How do you intend to present the "transformed" USPS to the public?

In April 2002, the Postal Service developed a communications plan to accompany the Transformation Plan. The communications plan provided suggestions to postal executives on communicating the contents of the Transformation Plan with the news media, employees, and customers. During a series of internal meetings in the spring of 2002, postal executives were briefed on key components of the plan, so that they could discuss with key stakeholders the human capital issues, operations challenges and growth strategies outlined in the plan.

Postal managers were encouraged to conduct meetings and briefings with a wide-range of audiences and to disseminate news releases and articles to their local newspapers to help educate the American public about postal issues. Communication strategies included speaking to local civic and rotary groups about the Transformation Plan, submitting guest columns to newspapers and conducting interviews with the news media about transformation.

At the national level, Postmaster General John E. Potter unveiled the Transformation Plan at the National Press Club. His presentation received publicity across the country as the Postal Service communications staff developed a satellite media feed from that event. Postmaster General Potter has conducted interviews with several key media representatives and continues to talk about transformation issues at industry conferences, speeches and other public venues.

As the Postal Service continues to make progress on the goals and objectives outlined in the Plan, our communications staff will work with management in developing appropriate communication materials for audiences nationwide.

20. Postal reform in several European countries has involved partial restriction of the letter mail monopoly; for example by limiting its application to packets at or below a specified weight. In your view, would some statutory limitation of the current monopoly be compatible with the transition to a more competitive, transformed Postal Service? How significant is the statutory monopoly in view of the increased use of e-mail and the internet as alternatives to letter mail?

Any proposed change must be evaluated within the context of the Postal Service's continued obligation to provide universal service to the American people. Even with the increased use of electronic mail, the use of the Postal Service is still the most common method Americans use to send and receive bills, statements, remittances, business messages, and other correspondence.

We believe that the Private Express Statutes remain an essential foundation for a postal system that is required to provide universal service and meet other public

service obligations. Nevertheless, we have also recognized that, as part of a reform package in which some postal services are substantially deregulated, the monopoly may need to be adjusted to assure that it does not apply to deregulated, competitive services. Accordingly, we have been willing to accept a legislative package involving some narrowing of the scope of the letter monopoly to exclude expedited or heavier-weight letters, provided that those services are genuinely deregulated.

21. The Transformation Plan includes an extensive discussion of different pricing strategies the Postal Service might pursue in the future as a Commercial Government Enterprise. Generally, these approaches include value-based pricing. One of the pricing strategies involves distinguishing between high-volume, frequent mailers and those who mail less regularly. Would this strategy result in higher prices for private citizens and small business who use stamps rather than postage meters or permits?

No. The Postal Service is committed to finding ways to keep mail services affordable for all its customers especially for private citizens and small businesses who have few alternatives to mail service. We intend to carefully examine any value-based pricing initiatives to ensure that implementing this type of pricing would not increase the cost of mail for small customers. Carefully designed, pricing initiatives for larger mailers will benefit all customers by increasing these customers' contribution to institutional (overhead) costs, thus reducing the burden on smaller customers.

22. Another potential pricing strategy discussed in the Plan is "purchase location segmentation." This strategy would charge a premium for postal services in areas where operational and fixed costs are higher. How would the Postal Service ensure that this strategy would not result in higher delivery charges for mailings to and from geographically remote areas of the nation, like Hawaii and U.S. territories in the Pacific.

The Postal Service intends to continue its current statutory mission of providing universal service with at least one uniform rate. The "purchase location segmentation" strategy discussed in the Transformation Plan refers to several possibilities, for example, (1) encouraging customers to use low-cost ways to complete retail transactions; (2) offering discounts for mail that is entered closer to destination and thus avoids certain mail processing and transportation costs; or (3) offering new products and services in a limited geographic area to test marketplace reactions.

23. Much of the discussion about negotiated service agreements or volume discounts focuses on large mailers with heavy volumes. I understand that mail prepared by many small, community businesses and nonprofits is more expensive for the USPS to process. However, I wonder what kind of discounts or incentives can be offered to these smaller mailers that will improve the quality of their mail and help to lower the combined costs of processing mail for the USPS and those mailers?

The Postal Service is looking at new incentives for smaller mailers that may encourage these customers to mail automation-compatible mail that helps to control Postal Service costs. While specific initiatives have not been finalized, possible opportunities include: (1) activities that reduce retail window use; (2) entry of mail at designated offices within a city rather than at neighborhood post offices; (3) entry of mail during designated "non-rush" periods or by appointment when post office staff is available to accept the mail; or (4) establishment of incentives to encourage several smaller mailers to consolidate their mailings.

24. It would appear that offering seasonal discounts would be of benefit to the Postal Service, its customers, and its employees especially since there are times when postal facilities are underutilized due to low mail volume. Many community-based groups send out annual calendars, membership solicitations and renewals, schedules of community events, and packets of updated volunteer information. Do you believe that given a window of seasonal discounts that these groups would be interested in helping to "level the workload" for USPS? If so, when can we expect to see the USPS file something on seasonal discounts with the Postal Rate Commission?

If a discount for the entry of mail during periods of low volume were offered, the Postal Service would encourage its use by all customers (including community-based groups) who met the requirements for the discount. These customers would be interested in this type of postage discount if mailing during the designated period met their organizations' needs. While encouraging off-peak use of the mail is an attractive opportunity, it must be considered within the framework of the current network and resource use pattern. For example, although resources are used less intensively during certain periods, these times provide an opportunity for staff vacations. We must work our way through these issues before any seasonal discount can be proposed to the PRC. We are studying all potential ideas and needed capabilities in our development of the Corporate Pricing Plan.

Purchasing/Procurement

25. Over 20 years ago, the Governmental Affairs Committee held hearings on the need for a centralized government contractor suspension and debarment system. It was found that too often contractors, who had been debarred by one federal agency, were continuing to do business with other federal agencies. To respond to this problem, a uniform federal suspension and debarment system was created. This debarment system also maintains a federal debarment list of thousands of contractors and persons who have been barred for fraud.

    With an annual procurement budget of almost $15 billion, the Postal Service is one of the federal government's largest procurement agencies; however, its debarred bidder list had fewer than 10 persons listed as of April 1, 2002. Why hasn't the Postal Service taken greater efforts to protect its massive procurement program from the fraudulent contractors who have been banned from the rest of the government, and why doesn't the Postal Service participate in this federal government-wide program?

Pursuant to statute (31 USC 6101 (note)) and Executive Order 12689, debarments and suspensions by a procurement activity under the Federal Acquisition Regulation have government-wide effect. The Postal Service is not such a procurement activity, so other government agency debarments and suspensions do not, as a matter of law, prevent the affected party from contracting with the Postal Service. The Postal Service does, however, direct its contracting officers to consult GSA's government-wide list of debarments and suspensions in establishing the capability of prospective postal contractors and to justify any decision to award a contract to an offeror included on the list. (Purchasing Manual (PM) 2.1.7.c.3(c).) Further, in an appropriate case, the Postal Service may undertake to debar or suspend a contractor based on its debarment or suspension by another agency. (PM 3.7.1.e.5. ; i.5.) Under this authority, the Postal Service recently took such action against Arthur Anderson and the Enron Corporation following their suspension by GSA.

26. Do your information systems capture past performance data of contractors? If not, what mechanism do you use to track performance and ensure that future contract awards are given only to competent contractors?

Since 1994, the Postal Service's Supply Management organization has used a Supplier Measurement and Tracking system (SMT) to capture past performance data on suppliers. The suppliers measured by this system primarily produce products to postal specifications. Currently, purchasing specialists manually track other suppliers providing commercial products or services. As part of contract closeout, purchasing and supply management specialists include a synopsis of the supplier's performance in the contract file that may be evaluated during the course of future purchases.

The Postal Service is developing a web-based Supplier Rating System that will be implemented this fall to capture annual performance information on all Postal Service suppliers. Purchasing and supply management specialists nationwide will use the system to examine past performance data on all contracts, regardless of the product or service.

27. The Postal Service states that it should not be bound by the Federal Acquisition Regulation (FAR) because the Act is too constricting and does not allow the Postal Service to contract in a flexible and efficient manner. However, the Postal Office of Inspector General (OIG) has noted that the Postal Service, in adopting its own suspension and debarment process, has established a procedure that makes it harder to debar fraudulent contractors than the FAR procedures. Do you believe the Postal Service makes it more difficult to remove fraudulent contractors than the procedures used under the FAR or by private industry?

The Postal Service believes that Congress has correctly excluded the Postal Service from the application of most "Federal law[s] dealing with public or Federal contracts" (39 USC 410(a)), and the result has been increased flexibility and efficiency for the Postal Service.

The distinction which the question notes involves the burden of proof necessary to debar a contractor on certain specific grounds, including violation of the terms of a government contract and "any other causes of a such serious and compelling nature . . . as may . . . warrant debarment" (Purchasing Manual (PM) 3.7.1.e.4). The FAR standard is "preponderance of the evidence," FAR 9.406-2(b)(1); the PM standard is "evidence that the Postal Service determines is clear and convincing," PM 3.7.1.f.3.

The "clear and convincing" standard was common to purchasing regulations predating the FAR (*see, e.g.*, Armed Services Procurement Regulation 1-604.1(ii) (1976)). The "preponderance of the evidence" standard was first adopted by the Office of Federal Procurement Policy in a 1982 policy letter (47 FR 28854, July 1, 1982). An earlier draft of that policy letter had proposed a "substantial evidence" standard. (46 FR 37832, July 22, 1981.)

The difference in standards has little role in the decision whether to initiate a debarment proceeding. Both the FAR and the PM provide that the existence of a cause for debarment does not require that the contractor be debarred; the seriousness of the contractor's acts or omissions and any remedial measures or mitigating factors should be considered in making any debarment decision (FAR 9-401(a); PM 3.7.1.f.), and the exercise of that discretion is far more significant in the determination whether to debar than the standard.

This difference in standards does not affect debarments based on the contractor's conviction of a crime in connection with its performance of a

government contract. Further, there is no obvious source of information about "the procedures used . . . by private industry [to remove fraudulent contractors]"; private industry has no "due process" obligation with respect to its dealings with its suppliers and no obvious counterparts to the suspension and debarment procedures followed by federal agencies.

28. The Transformation Report calls for revising purchasing regulations. What revisions are needed, and what can't the Postal Service do under current regulations?

Although the Postal Reorganization Act (PRA) generally allows the Postal Service to acquire goods and services in a manner akin to the best commercial practices, we have not taken full advantage of that freedom in our purchasing regulations. Instead, we have adopted detailed regulations that, to some extent, mirror federal-acquisition rules and that cover virtually all aspects of purchasing. Application of those regulations is time-consuming, expensive, and overly legalistic in many instances.

We plan to replace approximately 300 pages of regulations with a brief, simplified set of regulations that will allow the Postal Service the business freedom to purchase goods and services as envisioned in the PRA. Our new regulations will be easy to understand, will focus Postal Service personnel on purchasing goods and services of good quality at a good price, and will provide expedited means to inexpensively resolve business disputes. The new regulations will allow the Postal Service to enter into longer-term, supply-chain relationships with those suppliers who offer the best goods and services to the Postal Service.

As noted, the primary change is to focus postal purchasing toward the best commercial practices. In addition, we also are adopting greater freedom to choose our business partners. For example, in private industry, when a supplier is not responsive to its customers' needs, then the customer no longer deals with that supplier. The type of business behavior that would lead to such a business decision includes a pattern of unsatisfactory contract performance or bad-faith business dealings. Although we do not expect to exclude companies from competing for our business very often, some suppliers have demonstrated that it is simply too time-consuming and costly for us to want to do business with them. Whenever we feel it is inappropriate to continue to do business with a company, we will always give that company an opportunity to discuss the matter fully. That is a common practice in private industry.

Another revision is more general in scope. Our Purchasing Manual currently has the force and effect of law. That means suppliers can sue over postal business decisions whenever suppliers feel we have not observed our policies and procedures. Those challenges are often very expensive; they also often last several months, which sometimes disrupts needed acquisition of goods or

services in a timely manner. In tandem with the new regulations already mentioned, we intend to convert most of the current policies and procedures into internal guidelines, not subject to legal challenge. We will also establish an expedited, inexpensive process to address and resolve business disputes, focusing on informal meetings, mediation, and an ombudsman who will promptly resolve disputes if the parties are unable to do so.

29. What changes have you implemented on your analyses of high dollar lease/purchases to address the OIG's concern that these transactions should be reviewed and approved by the Board of Governors?

We assume this question arises from OIG Audit #TD-AR-02-002, Trailer Lease Justification. That audit report indicates that a decision analysis report (DAR) should have been prepared and Board of Governors' approval should have been obtained.

The OIG's report hinges, in part, on its reading of postal handbooks dealing with the DAR process. As the report reflects, postal management, including the acting manager of the organization responsible for those handbooks, disagreed with that reading. Because of that disagreement, postal management has not taken steps to implement the OIG's recommendations. We have worked with the OIG by exchanging information and holding several meetings to work through issues. While opportunities for improvement have been identified, resolution on all issues has not been attained.

We disagreed with several of the report's findings. We do not agree with the finding that the Postal Service could save $85 million over 12 years by purchasing trailers versus leasing them. Using estimates from the draft audit report, actual payment data, and proven postal business practices, over the 6-year term of the contract, the net benefit of the service contract is $48.7 million net-present-value (NPV), when compared to ownership. If the contract is renewed for an additional 6-year term, the NPV over the 12-year period is approximately $21 million. These comparisons do not take into full consideration the infrastructure increases required to maintain this fleet expansion, had purchasing been pursued.

It is clear that the major differences in our views and those of the OIG are in the assumptions used to project costs over the 6-year term of the contract and the potential 12-year term, if the option to extend is exercised. The consolidated national contract will provide clear cost data. We intend to use that data to perform another analysis, before any decision is made to exercise the option to extend the trailer contract.

30. Why doesn't the Postal Service not use the Decision Analysis process if the purchase is other than a normal operating expense, regardless of dollar amount? How does the Postal Service attract small, minority, or women owned businesses to its procurement and contract programs?

The purpose of the directives setting out the Decision Analysis process is "to ensure that the capital and expense investments of the Postal Service provide the necessary facilities, vehicles, and equipment to meet its goals relating to customer and employee satisfaction and revenue generation while ensuring accountability, credibility, and competitiveness." (Handbook F-66, General Investment Policies and Procedures, 1-2.) In that process, a Decision Analysis Report (DAR) is used "to recommend an investment for approval [by justifying it] either as an economic opportunity or as a means of sustaining existing postal operations into the future by correcting or eliminating a problem." (Handbook F-66, 1-3.1.1.)

In the context of the question, purchases "other than normal operating expenses" are subject to the Decision Analysis process if they represent investments which exceed the thresholds established for capital and expense projects. (Handbook F-66, Exhibit 2-1). It is not obvious what advantage would result from removing those existing dollar thresholds.

The Postal Service's Supplier Diversity program is a fundamental element in the Postal Service's corporate strategy to remain competitive and profitable in the marketplace. Our record is a good one, and because our business and financial challenges are more similar to those of the private sector than those of government agencies, the Postal Service has adopted more of a private-sector approach to supplier diversity. That approach is based on strengthening our supplier base by reaching out to identify strong suppliers and providing them with opportunities to compete for our contracts. Attracting small, minority and woman-owned businesses to compete for our purchase opportunities is one of the most central parts of our purchasing program.

We periodically benchmark our efforts against both the public and private sectors, and historically, results have proven substantial. For example, in 2001, we participated in a supplier diversity survey of Conference Board firms; the survey found that the Postal Service was a leader in the use of small and woman-owned firms, and "above average" with minority-owned firms. While direct comparisons are difficult given the wide differences among the data available for comparison, this leadership position was reconfirmed from a second source; in the second annual *DIV2000.com* survey of 100,000 small, minority and woman-owned suppliers, the Postal Service ranked sixth among public sector entities in promoting "multicultural business opportunities."

Earlier last year, the Postal Service was the only public sector entity chosen to participate, with a number of Fortune 100 firms, in the development of a Public

Broadcasting Service series on the importance of supplier diversity. The program is now being aired in several markets, and we use it as part of our ongoing supplier diversity training. We have also developed a Computer Based Training course addressing postal-specific supplier diversity issues. The course will be broadly distributed and used during 2002, and it appears so promising that at least one local chapter of the National Minority Supplier Diversity Council has requested to use the course.

The Postal Service continues to maintain close relationships with a number of the national associations and their affiliates that support supplier development and diversity throughout the country. In 2001, we sponsored or actively participated in an estimated 100 fairs and events focused on supplier diversity across the nation. The Postal Service web site, *www.usps.com*, contains a variety of material designed to provide information on how to do business with us, connects to buyers and key contact points, and delivers information on contract opportunities.

We would also like to point out that the policy changes mentioned above should make doing business with these entrepreneurs easier and even more effective. One of the impediments we have experienced is that the huge size and complexity of our current purchasing regulations makes it an awesome task for the small, minority or woman entrepreneur to seek postal business. We want that business, and the new policies will help us achieve even more than we have in the past.

31. How does the Postal Service implement and track recommendations made by the Office of the Inspector General reports to ensure the recommendations are fully implemented?

The Postal Service recently established a 10-person unit that is responsible for coordinating the interaction between management and the OIG, including assisting in the preparation of responses to audit report findings and recommendations. The unit has developed an automated information system that is used by both the unit's staff, Headquarters department and Area Office liaisons to track management's progress in implementing the corrective actions for each agreed-to recommendation. (In those infrequent cases where management disagrees with an OIG-recommended corrective action, the matter is submitted to a formal audit resolution process, with final resolution authority residing with the Service's Governors.) On a periodic and as-requested basis, the unit prepares status reports for senior management and the Board, showing the progress of all open recommendations. In order to close out a recommendation, the management official to whom the recommendation was addressed is required to submit documentation sufficient to demonstrate that the agreed-to corrective action has been implemented.

32. Since the OIG has been using DCAA to conduct audits of Postal Service contracts, what have you done to ensure that cost savings are realized?

The Postal Service's use of DCAA audits in connection with its contracts predates the establishment of the OIG. When DCAA audit information is available, it is used as a basis for negotiating settlements of contract disputes. Where such negotiations have been unsuccessful, the Postal Service has relied upon the DCAA audits for evidence in legal proceedings, and it expects that DCAA auditors will be called upon to testify in future contract trials.

Most DCAA audit requests are self initiated by the contracting officer for evaluation of supplier contract cost proposals in response to new purchase requirements and for modifications to existing contract awards. The DCAA audit reports are therefore considered advisory and are recognized as supplemental information for the contracting officer to use during supplier negotiations. Further, DCAA report recommendations and negotiated results are included in the contracting officer's file documentation. Copies are provided to the OIG. In addition, we are currently reengineering this process to ensure that potential cost savings outlined by DCAA audit reports are addressed promptly by the contracting officer, and the results are reported back to the OIG.

Mail Safety/Detection

33. At a recent hearing before the House Appropriations Subcommittee, the USPS Vice President for Engineering testified that intelligent mail, which provides information on the sender, "... gives the Postal Service a much higher level of security as compared to the anonymous mail that is dropped into the individual collection box." Do you believe mailer-applied unique identifiers act as a deterrent against the use of mail as a weapon, and if so, what can the Postal Service do to encourage the production of mail with mailer-applied unique identifiers and reduce the amount of anonymous mail?

There is reason to believe that mailer-applied unique identifiers act as a deterrent against the use of mail as a weapon. This is based on the argument that if the Postal Service can trace a mail piece to the originator, an individual is less likely to use the mail as a weapon because of the increased likelihood that the individual would be caught and brought to justice. Sources of anonymous mail can be commercial mailers and individual consumers. The Postal Service is investigating strategies to reduce anonymous mail from both sources. With commercial mailers, we are developing enhanced security processes. If mailers meet a set of security standards, their mail will be considered "safe" and will not require special handling. This shared responsibility would help to keep security costs down. At the individual consumer level it is a more challenging issue. With individual personal transactions at a retail counter, mail pieces could be uniquely identified and associated with the customer. This would be performed by the Postal Service as an automated part of retail transactions.

When compared to anonymous collection mail, intelligent mail could be used to identify the sender, the contents of the letter or package, the origin of the mailed item, the intended recipient and the item's intended destination. Historically, criminals have used fictitious address information and the anonymous collection stream to introduce injurious articles such as extortion letters, violent threats, and explosives. Intelligent mail would enhance law enforcements' ability to assess risk by identifying mailers and suspect contents. With knowledge of the improved safeguards associated with mail, criminals would be discouraged from using the mail to transport hazardous and unauthorized materials due to the increased likelihood of being identified as the mailer.

The Postal Service currently uses intelligence on mailed items to provide mailers with information on processing and delivery, such as delivery confirmation. PC postage also uses an information based indicia that provides extensive information on a mailpiece. Intelligent mail would expand the use of intelligence for security purposes and increase the public's confidence in the mail.

34. You have testified that trusted mail which has an individual piece marking presents significantly lower risk of terrorism than anonymous mail. I understand there is no perfect security, but given the significantly lower risk, what is the Postal Service doing to encourage trusted mail, and who will pay these costs?

As noted in the answer to question 33, the costs of security would be shared by both the Postal Service and the commercial mailer. Provided the commercial mailer met a set of security standards, mail from these mailers would be considered "safe" and would not require special handling. This would both save money and improve service. The cost of reducing anonymous mail at the retail counter would be borne by the Postal Service. The remaining anonymous mail would require special handling, and the costs would have to be absorbed by the Postal Service.

35. What additional operational and capital costs does USPS expect to incur in the short- term for security related expenses? How will these additional costs affect the Postal Service's financial situation over the next two years, and who will pay these costs?

A number of security initiatives to protect postal employees and customers from exposure to biohazardous materials have been identified in the Postal Service's Emergency Preparedness Plan (EPP). At this point, the EPP defines the primary initiatives and estimated funding requirements relative to reducing risk against biohazards (terrorism). Although the specific funding required for individual initiatives may vary from what is currently documented in the Plan, it is anticipated that the total level of funding required for these initiatives will be

covered by the $587 million in 2002 appropriations already approved by Congress and the $799.8 million in FY 2003 requested appropriation.

The EPP does not discuss recurring costs associated with the impact of these initiatives on maintenance and operations. These recurring costs have not been included in any of the Postal Service's appropriation requests.

The recurring operating and maintenance costs of these security initiatives may be significant. These can be grouped into four general categories: (1) the cost of continued irradiation of selected mail at certain locations, which will include costs to prepare mail for processing and operating labor; (2) the implementation of detection technologies will also incur significant recurring costs, primarily the cost of the reagents used to detect hazardous substances; (3) the operation of filtration equipment, primarily retrofitted on existing mail processing equipment, will also increase operating costs, especially electricity; and (4) there will be ongoing support costs for these and other efforts, including the costs to plan, develop, implement, and maintain mail security policies and practices.

At this time, it is not possible to quantify these recurring costs with an acceptable degree of precision. As the security initiatives are further developed, the associated cost impacts will be better quantified.

The recent terrorist attacks have further heightened the Postal Service's awareness of the need to manage security and mitigate risks to physical and information assets. A variety of internal assessments and enhancement initiatives are currently ongoing and planned. The costs of these initiatives are expected to be funded internally.

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QUESTIONS FOR POSTMASTER GENERAL JOHN POTTER
FROM SENATOR THAD COCHRAN

1. Given the significant funding the Postal Service has requested for mail security, what steps have been taken or are planned to separate out anonymous "high risk" mail so that security efforts can be focused there? In other words, what are you doing to maximize trusted mail that is individually marked so that we don't have to spend public dollars where it's not needed?

The Postal Inspection Service has recently initiated a program with the Postal Service and the commercial mailing industry that would identify commercial mailers who comply with specific security practices. This program, identified as the Trusted Mail Provider (TRUMP) program, is a voluntary process whereby commercial mailers would certify their compliance with specific practices related to facility and personnel security. When a mailer identifies itself as a trusted mailer, postal inspectors would review the mailer's operation and hiring practices to determine compliance. A mailer would be deemed a trusted mailer if its operations and hiring practices include adequate security provisions. Inspectors will evaluate opportunities to enhance security at commercial facilities, when necessary, and make recommendations for improvement. Should a future event occur that requires special handling of mail, mail from a trusted provider could bypass these measures depending on the nature of the threat.

2. I understand that all risk cannot be removed from the mail stream. But what can commercial mailers do to assist the Postal Service in streamlining security measures so that mail that comes from a secure commercial mailer with a meter indicia or permit and goes directly into the Post Office can stay secure and not be subjected to additional screening and decontamination?

Commercial mailers have been asked to familiarize themselves with the security criteria of the TRUMP Program and are invited to implement the necessary protocols for recognition as a compliant participant in this program. If a future event requires additional screening or decontamination, mail from the trusted mailers group may be processed without the additional requirements. Participation in TRUMP is voluntary and would be one indicator of a mailers' willingness to streamline postal security measures. Operationally, this would enable local postmasters to make decisions regarding which mail could be inducted directly into the mail stream and which should be further screened.

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QUESTIONS FOR POSTMASTER GENERAL JOHN POTTER
FROM SENATOR FRED THOMPSON

1. Today's Postal Service is a vital part of a $900 billion mailing industry. It is important, therefore, to address exactly what Americans want from their Postal Service. The core mission of the Postal Service has always been letter delivery. In past years, however, the Postal Service has been branching out its services into new and varied ventures. What do you think the mission of the Postal Service should be?

The Postal Reorganization Act (PRA) affirmed the historic mission of the Postal Service to bind the nation together by providing all Americans with a universal, affordable way to communicate with each other. The PRA was intended to ensure that these services would evolve and remain robust in a business and social climate that was becoming increasingly dynamic. The drafters of the PRA also anticipated the need to develop new products and services when they wrote that the Postal Service would be "forever searching for new markets and new ways by which the communication needs of the American people can be served." The Postal Service's historic mission is still relevant today and will remain relevant in the future. Our exploration of new and varied ventures is entirely consistent with this mission and is, in fact, essential – not only to serve the changing needs of our customers but also to develop a more diversified financial base with which to support universal service.

2. According to the Postal Reorganization Act of 1970, the universal service obligation requires the Postal Service to provide prompt, reliable, and efficient services to patrons in all areas, and render postal services to all communities at fair and equitable rates. The Transformation Plan discusses the broad scope of this definition and reviews the ways in which other countries and industries have addressed the issue of universal service obligations. In light of these reviews, do you think the definition of universal service that we commonly use is sufficient, or should it be modified? Please explain.

Conceptually, the definition of universal service, as it is commonly used, is valid. However, some aspects of this definition may need to be modified 1) to serve the changing needs of the nation, 2) to reflect the changing landscape of opportunity, and 3) to address the need to modify the Postal Service's 30-year-old business

model. Americans still need and deserve prompt, reliable, and efficient services in all areas, with access to postal services in all communities at fair and equitable rates. What may need modification is the way in which the universal service is provided. For example, everyone now receives the same basic delivery service, whether or not that service is appropriate for their needs. In the future, a basic service could include different delivery days in various areas, according to local customer needs and the overall imperative to maintain efficiency, with additional services available based on customer requirements.

The cited language from the Postal Reorganization Act provides a broad, comprehensive description of universal service that remains very satisfactory and relevant to today's postal system. The Transformation Plan pointed out that, after the general principles embodied in the 1970 law were enacted, a detailed post office closing and appeal provision was added. Also, annual appropriation riders have been enacted prescribing a freeze in certain services at the 1983 level, along with other limitations. We believe that universal service remains the overriding purpose of the postal system. To continue achieving that goal at affordable prices, services and facility networks must be adjusted from time to time, in line with changing conditions. For example, as the population shifts and habits change, services and networks should adjust to match current needs, not the needs of the past. In sum, we believe that portions of the current law are out of tune for a modern postal system providing universal service. The difficulty is not with the basic formulation of universal service, but with the later, more specific provisions making it more difficult for the Postal Service to match resources to needs over time.

3. GAO's February 28, 2002 report on the Postal Service's increased need for transformation posed a critical question:... What type of governing board is appropriate for USPS given the complex mission and role of this $70 billion entity with its nearly 900,000 employees?" Unlike the GAO report, the Transformation Plan did not address this issue. Please explain whether or not you feel the current governance structure is appropriate to handle an agency of the Postal Service's magnitude. Are there any alternative structures that you feel should be considered? If so, please describe them?

The current system of governance is designed to allow the Postal Service to be operated in a businesslike manner, while preserving the public character of the nation's mail system. The Board includes nine Governors who are appointed by the President, with the advice and consent of the Senate, to represent the public interest generally. The Governors are appointed for staggered nine-year terms to insulate the postal system from partisan political influence. The Governors provide a balance of experience and perspective designed to assure the Postal Service of the best possible management. They, and they alone, appoint and determine the tenure of the Postmaster General, the chief executive of the Postal Service. Their duties also include approving the PRC's recommended rates and

classifications, as well as directing and controlling expenditures, long-range planning and setting postal policy. The Board also takes up matters such as service standards, capital investments and facilities projects exceeding $10 million. In all these matters, the Governors serve as the guardians of the public interest. We believe that this structure of governance has served the nation well over the past three decades, and should not lightly be set aside.

4. The Transformation Plan proposes that the Postal Service replace the current binding arbitration requirement with provisions similar to the Railway Labor Act, which allows employee strike and agency lockout authorities.

a. What other avenues have you reviewed regarding how the Postal Service might address its employees' labor issues and contracts?

The Postal Service has also considered changing the current binding arbitration provisions to emphasize mediation as a means of resolving collective bargaining impasses.

b. What strategies do you believe would be most effective in improving labor-management relations?

The Postal Service believes its current strategy of jointly addressing disputes at the national level, using an understanding of both vested and mutual interests to resolve those disputes, and communicating those resolutions to the local level is the most effective dispute resolution model to pursue to improve labor-management relations. It is essential that the parties at the national level conduct themselves in this manner, setting an example for labor and management in the field so this model is ultimately migrated to the field. Pursuing an interest-based strategy of dispute resolution has proven successful with the NALC, and, we are confident, will prove successful with our other unions as well.

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QUESTIONS FOR POSTMASTER GENERAL JOHN POTTER
FROM SENATOR CARL LEVIN

1. I understand that the Postal Service is planning to lift the moratorium on post office closings.

   a) What are the criteria for determining which post offices will be closed?

   With the lifting of the moratorium, the Postal Service's immediate focus will be on completing the necessary paperwork on approximately 500 Post Offices that had been previously suspended due to emergency situations beyond the control of the Postal Service. An ongoing retail network optimization is looking at the entire national retail network to create a comprehensive proposal for putting services where they are needed. The Postal Service will employ a criteria-based methodology to accommodate growth and eliminate redundancies.

   b) What type and degree of Congressional and local consultation will there be before a post office is closed?

   Postal Service procedures provide full opportunity for public comment prior to any proposal to close a post office. If the Postal Service determines that a closing is warranted, a written proposal to close or consolidate the office must be posted for 60 days to solicit public comment. If after reviewing the comments received during this period discontinuance is approved, a final determination must be written. This is then posted for 30 days during which time local postal customers may appeal the final decision to the independent Postal Rate Commission (PRC). The PRC has 120 days to review the Postal Service decision and render a final opinion. Additionally, the office may not be closed until 60 days after the final decision is initially posted. Provisions are also made for retention of the community name as a mailing address in the event a post office is closed or consolidated with another facility.

c) What effort will be made to relocate the staff of a closed post office?

The Postal Service is focusing only on completing the necessary paperwork on offices that had previously been emergency suspended. These post offices are not currently in operation. They have no postmaster, no other employees, and in some cases the building no longer exists. The Postal Service will make every effort to relocate an employee when an office has been suspended or has been approved for discontinuance.

2. Some of my constituents who are Postal Service employees have contacted my office with concerns about the Postal Service's Family and Medical Leave policies. Some report that their supervisors have been reluctant to permit them to take family or medical leave time, while others have faced delays in being granted leave. Please clarify the process the Postal Service uses for approving employee leave under the Family and Medical Leave Act. Also, please describe what recourse is available for employees who are denied leave.

The Postal Service, like much of the federal government, initially managed the Family Medical Leave Act (FMLA) program through the front line supervisor. As the law has developed, however, it has become clear that making FMLA determinations is a more complex task than many supervisors and managers have time or expertise to perform.

Accordingly, in July 2000, the Postal Service started to roll out a new program called Resource Management, one component of which is the centralization of FMLA decision making. As part of this process, approximately 500 supervisors and managers have participated in in-depth training on the proper management of FMLA. Presently over 440,000 of the 760,000 career Postal Service employees have their attendance and FMLA administration processed through centralized locations. We are expanding this program weekly and should have over 600,000 employees in this system by the end of calendar 2003. The centralization of this process has standardized the Postal Service's administration of FMLA, resulting in more consistent decisions. When decisions on FMLA status are delayed due to a need for additional information regarding the employee's health condition, FMLA protection is provisionally granted pending receipt of the necessary information.

We are currently working with the Department of Labor (DOL) to provide presentations to each regional Wage and Hour office on this new approach to FMLA management in the Postal Service. We hope to work cooperatively with DOL to establish regular meetings at the regional level to discuss FMLA issues. Employees who are dissatisfied with the Postal Service's decision on the FMLA status of their leave are usually able to pursue the issue through the grievance process or through an internal administrative process.

3. Several members of my staff have been informed by the Postal Service that there are no longer any delays to the mail caused by the anthrax attacks. However, we have received a significant amount of mail over the last few weeks that were sent in November and December. Please tell me how long we can expect this to continue and why mail remains undelivered from the time of the anthrax attacks.

The irradiation of all letter-size and flat-size mail has been kept current since March. Since that time we have had a steady flow of letters/flats to and from the irradiation treatment facility. The irradiation process has added approximately 5-7 days to the delivery time for mail, which reflects the time within the Postal Service. Additional delays occur depending upon the procedures followed at particular branches of the federal government.

Other delays may be the result of mail held by various federal agencies and sent back to the Postal Service over the last several months. No more mail of this type will be processed by the Postal Service.

Parcels, which require X-ray treatment, will be current as of June 21. The delay was due to our need to fine tune the X-ray equipment needed to sanitize parcels.

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QUESTIONS FOR POSTMASTER GENERAL JOHN POTTER
FROM SENATOR THOMAS R. CARPER

1. I was happy to see that you included in the Transformation Plan a promise not to raise rates in until 2004 because it means you realize that continually raising rates will only drive more of your customers away. How realistic is this promise and where exactly would the $5 billion in savings that would enable you to keep it come from?

If volume growth returns in Fiscal Year 2003 and the Postal Service does not suffer from any new economic downturns, the promise to defer the rate increase is realistic and will be met.

The $5 billion in savings comes primarily from capital programs and breakthrough productivity initiatives. These programs are outlined in *Appendix M -- Efficiency-Based Strategies of the Transformation Plan.* Purchasing initiatives, including supply-chain management, and transportation cost savings are also expected to contribute to the $5 billion in savings. The $5 billion in cost savings over a five-year period represents an average of $1 billion a year in incremental cost savings. In its best year, the Postal Service has achieved savings close to this amount but has not previously been able to achieve this level of savings year after year. It will take extraordinary commitment and successful implementation of the Performance-Based Strategies outlined in Appendix O of the Transformation Plan to ensure the capture of these projected savings over the complete five-year horizon.

2. As I'm sure you know, the Office of the Consumer Advocate issued a report at around the time the Postal Rate Commission was about to approve the latest rate increase that called into question the performance of Priority Mail and a number of other Postal Service products. In addition, the Comptroller General in the written testimony he submitted before the hearing points out that on-time performance for First Class mail has eroded in recent months. What steps are you taking, or what steps will you take, to address the issues raised by the Consumer Advocate and GAO?

As you are aware, the tragic events of 9/11, and the subsequent use of the mail to initiate anthrax attacks, had an immediate impact on our ability to provide

consistent levels of customer service. However, I am pleased to report that through the efforts of our dedicated workforce, we have overcome significant challenges to produce service performance levels that are approaching record high marks.

As background, prior to the alliance with FedEx, a substantial amount of Priority Mail was carried by commercial air passenger transportation. The balance was transported on our own dedicated surface and air transportation networks. Performance scores were trending downward, however, which prompted us to seek a more streamlined contract solution. During Fiscal Year 2001, our performance had declined in each of our 13 Accounting Periods, as compared to Fiscal Year 2000, with the average decline being 4.3% over the whole of Fiscal Year 2000. We selected FedEx as our partner in an effort to improve service to more dependable levels. However, this was based on the assumption that commercial air passenger transportation would still be available for Priority Mail. After the terrorist attacks effectively removed this transportation option, we relied on a variety of alternatives, coordinated over time to rely on FedEx for a greater percentage of our transportation requirements. Our performance scores reflect this time of transition from September 2001 through approximately January 2002 (Accounting Periods 1 through 5), followed by a period of dramatic improvement from January to the present.

3. As I'm sure you know, the Postal Service's workplace safety record is among the worst in the federal government. More than $1 billion is spent every year on workers —compensation payments and the Postal Service currently owes more than $5 billion in payments in future years. These are costs that are passed on to ratepayers. I was disappointed, then, to see that the Transformation Plan includes no real plans to reduce the number of workplace injuries at the Postal Service but instead proposes moving older or previously injured workers out of injury prone jobs and asks for changes in the law that would reduce the amount its has to pay out to injured workers. In your oral testimony at the hearing, you referred to efforts the Postal Service has taken recently to reduce injuries and expressed satisfaction with the progress that has been made. What steps have you taken? I know that OSHA, after studying workplace safety at a number of Postal Service facilities recommended that you employ an outside consultant to find a way out of your safety problem. Has this taken place?

Since the passage of the Postal Employees' Safety Enhancement Act (PESEA) in 1998, the Postal Service has been changing the paradigm of its safety and health program. We began with a new management commitment, involvement, and accountability. We began to measure not only accidents and injuries, but the program itself, using the Occupational Safety and Health Administration (OSHA) recommendations for program evaluations, contained in their proposed program standard. Results of program evaluations have shown continued improvement, and contributed to our recent successes in acquiring status in OSHA's Voluntary

Protection Program (VPP) for several postal facilities. This program provides for Federal agencies, and certain contractors at VPP sites, to join the program's three levels which include: *Star*, the most prestigious program for companies with excellent safety and health programs; *Merit*, for companies with good programs trying to reach Star level; and *Demonstration*, for companies with excellent safety and health programs that have innovative features OSHA desires to evaluate.

We have tasked management with reducing the OSHA injury and illness rates, and those rates have come down dramatically this year.

We are not aware that OSHA has recommended that we employ an outside consultant to "find a way out of your safety problem." We believe we have already sought a leadership role in employee safety and health and developed a world-class program with advanced tools. We have also expanded partnership activities with OSHA to increase compliance and further reduce occupational injuries and illness. We have used private sector expertise as appropriate in developing the programs and advanced tools, as well as for support during the recent terrorism/anthrax crises. Nevertheless, we are responsible and accountable for employee safety and health and cannot delegate that responsibility to a consultant seeking to do business with the Postal Service.

David M. Walker
Comptroller General of the United States

Enclosure I

Questions for the Record from Senator Daniel Akaka

1. **How do you rate internal controls over purchasing? Would you advise the Postal Service to have more discretion by its contracting officers?**

We have not reviewed the Postal Service's internal controls over purchasing for many years. Therefore, we do not have advice to offer at this time regarding the discretion of the Service's contracting officers.

2. **The Postal Service has contracted with the same public accounting firm for the last 25 years. In light of recent events surrounding Enron and Andersen, do you believe changes should be made for postal audits?**

According to postal officials, the Postal Service has rebid the contract for the external audit approximately every 3 to 5 years since 1972. They further noted that the Postal Service is currently in the process of rebidding the contract for its external financial audit and it expects to announce the contract award soon. We believe that the decision as to who will serve as the Service's external auditor should be made by the Board of Governors. In making this decision, the Board needs to consider a variety of factors, such as the independence, objectivity, integrity, past performance, and technical competence of the firms being considered as well as the views of the Service's Inspector General. However, the Board's responsibility does not end with the selection of an outside auditor. The Board, and in particular its audit committee, has an important role to play in assuring fair representation and appropriate accountability of management in connection with the Service's financial reporting, internal controls, compliance, and related matters. The Board should ensure that postal management reports timely and reliable financial information and provides reasonable financial disclosure to understand key trends and risks related to the Service's financial condition and outlook. In this regard, in our view, the Board should place special emphasis on reviewing the accounting for and disclosure of the Postal Service's significant pension and retiree health obligations.

3. **You have warned for some time that the unreliability of the Postal Service's financial numbers hampers its ability to provide accurate financial forecasts. One of the cornerstones to accurate economic forecasting is the ability to track data. How would you grade the Postal Service's information technology structure and what recommendations would you make to strengthen it?**

We have not reviewed the Postal Service's information technology structure and thus are not in a position to assign a grade at this time. However, we are currently conducting a review of the Service's information technology investment management capabilities to determine (1) the Service's capabilities for managing its information technology investments and (2) what actions the Service plans to take to improve its investment management capabilities. We are using GAO's Information Technology

Investment Management framework to conduct an assessment of the Service's processes for managing information technology investments necessary for achieving business goals. Specifically, we are comparing actual practices to practices in the GAO guide to determine whether the Postal Service has implemented the processes necessary to effectively manage its information technology investments. We expect to issue our report on this area later this year.

Although our work has been limited in the information technology area, we recognize the connection between information technology and the ability to track vital data. For example, the Service is in the process of deploying an "information platform" to provide reliable, real-time information on mailings, which will entail capital investments in information technology. However, completion of the platform is expected to take years, and mailers have urged the Service to make more rapid progress. In addition, the Service has recognized the need for an activity-based costing system in mail-processing facilities that would track specific costs, and Service officials have told us that such a system will be deployed in the near future. Moreover, the Service has recognized the need for improved data quality on postal costs collected by various statistical systems and special studies. The Service has outlined a multi-year strategy for improving data quality in systems that track carrier, clerk, and transportation costs, systems that track operations data, and systems that track data on the revenue, pieces, and weight of mail. In this regard, follow-through will be critical and will depend on the continued availability of budget and other resources.

4. Are you concerned that the Postal Service may not have the financial resources it needs to implement its Transformation Plan? What tradeoffs might need to be made?

We are concerned that the Postal Service may not have the financial resources it needs to fully implement its Transformation Plan. The Service's financial condition is deteriorating, with declines in mail volume leading to declines in revenues. Revenues are declining faster than expenses, in part because many expenses are fixed, and in part because the Service continues to experience difficulties in achieving and sustaining increases in its productivity. As a result, continuing deficits and cash flow difficulties are limiting funds available for capital investment, which is currently inadequate to maintain and modernize postal infrastructure. At the same time, the Service is approaching its $15 billion statutory debt limit with no debt reduction plan. Further, the Service anticipates growing expenses relating to major liabilities and obligations that are estimated at close to $100 billion, which include liabilities for pensions, workers' compensation benefits, and debt to the Treasury; and other obligations for post-retirement health benefits. In addition, expenses related to enhancing mail safety and security are a key unknown cost factor, and it is uncertain to what extent Congress will pay for these costs, but the price tag may be substantial. Finally, the Service's ability to cover its expenses by raising postal rates may be limited. For example, the Postmaster General has committed to keep rates steady from mid calendar year 2002 until 2004. However, even if the Service manages to

hold rates down, much larger declines in mail volume may be in the offing if mailers shift to electronic and other alternatives to the mail.

Thus, tradeoffs are likely to be required between achieving various desirable outcomes. In the short term, given any set of postal rates, the Service must make tradeoffs between (1) operating expenses, which may affect the quality of service, (2) capital expenses, which affect the extent to which the Service can maintain and improve its infrastructure, including investments to improve productivity, and (3) debt reduction, an outcome that would contrast with the growing level of debt due to the Service's continued deficits and reliance on borrowing to finance its capital program. In the longer term, tradeoffs may need to be made between the scope and quality of universal postal service and postal rates; such options might include fewer delivery days or higher rates for certain services. These tradeoffs may be affected by the degree to which legal and practical constraints will continue to limit transformation efforts in the future. For example, retail postal services may be maintained or improved if retail services can be provided with more points of service while relying less on traditional brick-and-mortar post offices.

In order to avoid ever more unpalatable tradeoffs, it is important to recognize that the Service's business model will not work in the 21st century, and the time has come for comprehensive and fundamental reform. Difficult and controversial issues (e.g., defining universal service and rationalizing infrastructure) must be addressed, and the parties involved will need to find common ground in building a postal system for the 21st century. As I testified before this subcommittee, shared sacrifice from all stakeholders will be necessary to achieve a successful postal transformation.

5. **GAO has made recommendations for the Service to improve the transparency of its financial information. You testified last spring that the USPS should provide quarterly financial reports on its web site. However, your testimony pointed out that the Postal Service has posted only one quarterly report to date, and that was for the third quarter of fiscal year 2001. How important are these quarterly reports to understanding the USPS' financial results and outlook? What other shortcomings do you see in this area, and how much progress has the USPS made in implementing GAO's recommendations in this area?**

Quarterly financial reporting, at a minimum, is very important to understanding and analyzing the Service's financial condition and outlook. Timely, relevant, and accessible financial information is needed to increase transparency and accountability, which are fundamental principles to ensuring public confidence in the Service. Financial statements, the center of present day business reporting, would help provide stakeholders, including Congress, the public, and ratepayers, with a comprehensive understanding of the Service's financial condition and outlook—which is becoming increasingly dire. Additionally, periodic financial reports afford Congress, stakeholders, and the Service the opportunity to understand differences between budgeted and actual amounts, improve financial planning, and take action to

address potential problems in a timely manner. The Service's current financial condition, which includes continuing deficits, severe cash flow pressures, liabilities exceeding assets, frequent rate increases, and requests for Congressional appropriations, has concerned many stakeholders. Given the vital role of the nation's postal system, it is imperative that these stakeholders understand the risks facing the Service, its financial condition and outlook, and the actions that it is planning to take. Specifically, for some of the actions that the Service is requesting as part of its Transformation Plan—i.e. additional flexibility—it will be important to couple an appropriate level of transparency and accountability with these actions. This movement towards increased transparency and accountability parallels the concerns raised in the private sector, especially considering recent failures of large corporations.

The Service has agreed with our recommendation to improve the transparency of its financial data and stated that it was providing financial reports on its Web site in a more timely and user-friendly manner. The Service provided one quarterly financial report for fiscal year 2001—for the third quarter. For quarters 1 and 2 of fiscal year 2002, the Service posted the chief financial officer's slide presentation to the Board of Governors on its Web site. The Service stated that it would continue to post the chief financial officer's quarterly financial presentations to the Board of Governors on its Web site. As we have testified, these financial presentations do not provide sufficiently detailed information for stakeholders to understand the Service's current and projected financial condition, relevant risk factors, or how its financial outlook has changed. These presentations do not include cash flow data, explanations of significant variances to plan, actions the Service plans to take in the short term, and revised year-end projections. It would also be useful for the Service to provide easy access to previous quarterly reports and presentations. More timely and accessible financial information is needed. We are looking at this issue more in depth and will provide additional clarification of what is needed in this area as we follow up on our recommendation.

Enclosure II

Questions for the Record from Senator Fred Thompson

1. **According to the Postal Reorganization Act of 1970, the Postal Service is required to maintain compensation and benefits for all of its employees on a standard comparable to the compensation paid in the private sector. The comparison was intended to refer to compensation for comparable levels of work, however, in practice, compensation has been comparable to wages in highly unionized industries unrelated to mail processing and delivery. In oral testimony, you stated that the comparison definition was subjective. Do you think "comparable pay" should be defined by law to clarify the interpretation? Please explain.**

Currently, the law requires the Postal Service to maintain compensation and benefits for all of its employees on a standard comparable to the compensation and benefits paid for "comparable levels of work in the private sector of the economy." The question of what basis should be used to determine the comparability of wages and benefits has been the subject of many arbitrations and continues to be debated. This is an issue that needs to be addressed and some changes in the law may be needed. However, more information is needed related to the appropriate comparative group and the total competitive package, including compensation, as well as total benefits such as pension, retiree health, and a variety of other benefits. We have recently begun a review of the pay and benefits policies and practices for the Service's major pay plans and the effects of the Service's compensation policies.

2. **The Postal Service has committed to generating $5 billion in savings and cost avoidance through 2006.**

   a. **Do you think the Postal Service has set an appropriate goal?**
   b. **Are there any adjustments you would recommend to either the measures proposed or projections forecast? If so, please explain.**
   c. **What residual effects do you see from these cost cutting efforts?**

The Postal Service's goal of generating "$5 billion in savings and cost avoidance through 2006" is somewhat unclear, but an average savings of $1 billion per year seems to be a modest goal for a $70-billion entity, particularly given the Service's current financial problems and reported cost savings in recent years. Regarding the Service's goal, it is unclear how the Service will define "savings and cost avoidance" and how the Service will measure progress in this regard. Questions that arise include:

- Do "savings and cost avoidance" include lower levels of spending associated with declining mail volumes? Or, are "savings and cost avoidance" to be defined more narrowly, such as savings associated with specific actions that improve postal productivity?

- How does "cost avoidance" factor in? For example, would cost avoidance generated from additional mailer work sharing efforts count toward the goal?
- What is the baseline for measuring "savings and cost avoidance" – the current level of expense, budgeted expense, or projected expense?
- How will "savings and cost avoidance" be measured?

As we recently reported, the Service has had difficulty tracking specific costs and the results of various cost-saving initiatives. Although the Service estimated it saved $900 million in fiscal year 2001 from increasing its total productivity, and another $1.6 billion in fiscal year 2000, it did not report—and may not be able to produce reliable data on—specific savings from its productivity initiatives. Looking forward, it will be important for the Service to more clearly define its cost-cutting goal, disclose how it will measure progress toward this goal, and regularly report on its progress in this area.

We hope the Service will achieve considerably more savings than targeted in the Transformation Plan. The Postal Service's modest $5-billion goal for savings and cost avoidance, however defined, would be consistent with the Service's historical difficulties in cutting costs and achieving and sustaining increases in its productivity. The Service's overall productivity has increased only 11.5 percent over the past 3 decades through fiscal year 2001, and these limited productivity gains have resulted in postal costs and rates being higher than they otherwise would have been. The Service's reported savings of $2.5 billion in fiscal years 2000 and 2001, while commendable, represented less than 2 percent of the Service's reported expenses over the same period. The Service needs to do more, especially if the Service is to hold rates steady from mid 2002 calendar year until 2004, as it has planned, while also reducing debt and financing needed capital investments.

The residual effects of the cost-cutting actions outlined in Service's Transformation Plan are difficult to foresee, in part because it is unclear what the potential financial impact would be, particularly in the short-term, from the Service's planned actions during the transformation period. More specifically, it is unclear what the impact of planned actions would be on annual revenues and expenses or when financial benefits may be realized. Further detail on the costs and time frames associated with specific initiatives is necessary for stakeholders to better understand the financial impact of the Service's proposed measures and of achieving its goal for cost savings and cost avoidance. Based on the financial impact, a better understanding could be gained of what limitations may continue to be placed on the Service's capital program, as well as other possible residual effects that could impact the quality of service and postal rates.

Enclosure II

3. The USPS has an estimated $81 billion in future health and retirement costs. In light of the wave of retirement costs all federal agencies will be facing in 2015, what steps would you recommend that the Postal Service take in order to address its current overwhelming retirement obligations?

The Postal Service needs to get its financial house into order so that it will have sufficient cash flow to meet its health and retirement expenses – which entails making at least the minimum payments established by the Office of Personnel Management in accordance with law. In the short term, the Service can realize large net revenues and thus higher cash flows by increasing postal rates. However, in the long term, increasing rates may have diminishing practicality because rate increases affect the Service's competitiveness by increasing incentives for mailers to find other alternatives to the mail. The Postmaster General has recognized this, saying that the Postal Service is "pricing [itself] right out of the market" and has committed the Service to keeping rates steady from mid calendar year 2002 to 2004. Therefore, in the short term, it is important that the Service increase cash flow by cutting costs and improving its productivity. In the long term, the Service's basic business model is not sustainable and a comprehensive postal transformation will be required to fully address the Service's financial viability, including its ability to meet health and retirement obligations. Because of the seriousness of this issue, we are currently working on defining more precisely the Postal Service's retirement obligations and the alternatives that might be available to meet the requirements of these future obligations.