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Before the Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security, Committee on Homeland Security and Governmental Affairs, U.S. Senate

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U.S. POSTAL SERVICE

Action Needed to
Facilitate Financial
Viability

Statement of Phillip Herr, Director
Physical Infrastructure Issues





Highlights of GAO-10-601T, a testimony to the Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security, Committee on Homeland Security and Governmental Affairs, U.S. Senate

Why GAO Did This Study

The U.S. Postal Service's (USPS) financial condition and outlook deteriorated significantly during fiscal years 2007 through 2009. USPS was not able to cut costs fast enough to offset declines in mail volumes and revenues resulting from the economic recession and changes in the use of mail, such as electronic bill payment. In July 2009, GAO added USPS's financial condition to its high-risk list and reported that USPS urgently needed to restructure to improve its financial viability.

The Postal Accountability and Enhancement Act (PAEA) of 2006 required GAO to evaluate strategies and options for USPS's long-term structural and operational reform and report by December 2011. Because of USPS's financial crisis and the need for urgent action, GAO accelerated its work and issued a report (GAO-10-455) on April 12, 2010.

This testimony provides (1) information on USPS's financial condition and outlook and (2) GAO's perspective on the actions that are needed to facilitate progress toward USPS's financial viability. This testimony is based on GAO's recently issued report and recent testimonies on USPS's financial condition and outlook.

View GAO-10-601T or key components. For more information, contact Phillip Herr at (202) 512-2834 or herrp@gao.gov.

U.S. POSTAL SERVICE

Action Needed to Facilitate Financial Viability

What GAO Found

USPS is facing a major financial crisis. Mail volumes, the primary source of USPS revenues, declined by 36 billion pieces (about 17 percent) over the last three fiscal years (2007 through 2009). Mail volume declines were largely due to the economic downturn and changing use of the mail linked to the continuing shift to electronic communications and payments. USPS's financial outlook is poor as it projects future declines in mail volumes, stagnating revenues, large financial losses, increasing debt, and significant financial obligations, including for retiree health benefits. USPS projects a record loss of over \$7 billion in fiscal year 2010. Furthermore, USPS expects to borrow \$3 billion, bringing its total outstanding debt to \$13.2 billion, close to its \$15 billion statutory borrowing limit with the U.S. Treasury. Looking forward, USPS projects that by fiscal year 2020, total mail volume will further decline by 15 percent, to the lowest level since 1986. Absent additional actions to cut costs and increase revenues, USPS expects financial losses will escalate over the next decade.

GAO recently reported that making progress toward USPS's financial viability would primarily involve taking action to rightsize operations, cut costs, and increase revenues. Making the necessary progress would require USPS and Congress to pursue strategies and options that would

- reduce compensation, benefits, and other operations and network costs using the collective bargaining process to address wages, benefits, and workforce flexibility, as well as generating revenues through pricing and product flexibility; and
- address legal restrictions and resistance to realigning USPS operations, networks, and workforce.

USPS included many of these strategies and options in the action plan it issued in March 2010, but these planned actions under its existing authority will not be enough to make it financially viable. Therefore, action by Congress and USPS is urgently needed to

- reach agreement on actions to achieve USPS's financial viability;
- provide financial relief through deferral of costs by revising USPS retiree health benefit funding while continuing to fund these benefits over time to the extent that USPS's finances permit; and
- require that any binding arbitration resulting from collective bargaining would take USPS's financial condition into account.

To facilitate reaching agreement about the difficult constraints and legal restrictions that hamper progress, Congress could consider establishing a panel of independent experts, similar to the approach used by the Department of Defense's Base Realignment and Closure (BRAC) Commission, to coordinate with USPS and stakeholders to recommend a package of proposed legislative and operational changes needed to reduce costs and address challenges to USPS's business model.

Mr. Chairman and Members of the Subcommittee:

I am pleased to participate in this hearing on the U.S. Postal Service's (USPS) financial condition, a topic we have addressed in recent reports and testimonies. My statement will provide (1) information on USPS's financial condition and outlook and (2) our perspective on the actions that are needed to facilitate progress toward its financial viability.

My statement is primarily based upon our report released last week on USPS's business model.¹ The report responded to a provision in the Postal Accountability and Enhancement Act of 2006 (PAEA) that required GAO to evaluate strategies and options for the long-term structural and operational reform of USPS.² We also drew on our recent testimonies on USPS's financial condition and outlook and our July 2009 report in which we added USPS's financial condition to our high-risk list.³ For our recent report, we primarily drew on this past work; other studies; USPS data; interviews with USPS, unions, management associations, Postal Regulatory Commission (PRC), and mailing industry officials; and stakeholder input. We conducted our work in accordance with generally accepted government auditing standards. Additional information on scope and methodology is available in each full product. Related GAO reports and testimonies are listed in the attachment to this statement.

USPS's Financial Condition Has Deteriorated and Its Financial Outlook Is Poor

USPS is facing a major financial crisis. Mail volumes, the primary source of USPS revenues, declined by 36 billion pieces (about 17 percent) over the last 3 fiscal years (2007 through 2009). In particular, First-Class Mail and Standard Mail—which together accounted for 94 percent of volume and about 78 percent of revenue in fiscal year 2009—experienced major declines. These declines were largely due to the economic downturn and the continuing shift to electronic communications and payments.

Both USPS and Congress took actions in fiscal years 2007 through 2009 to help offset these declines by reducing billions in USPS costs. For example,

¹GAO, *U.S. Postal Service: Strategies and Options to Facilitate Progress toward Financial Viability*, GAO-10-455 (Washington, D.C.: Apr. 12, 2010).

²Pub. L. No. 109-435, §710, 120 Stat. 3198 (Dec. 20, 2006).

³GAO, *High-Risk Series: Restructuring the U.S. Postal Service to Achieve Sustainable Financial Viability*, GAO-09-937SP (Washington, D.C.: July 28, 2009). USPS's transformation efforts and long-term outlook were on our high-risk list from 2001 to 2007.

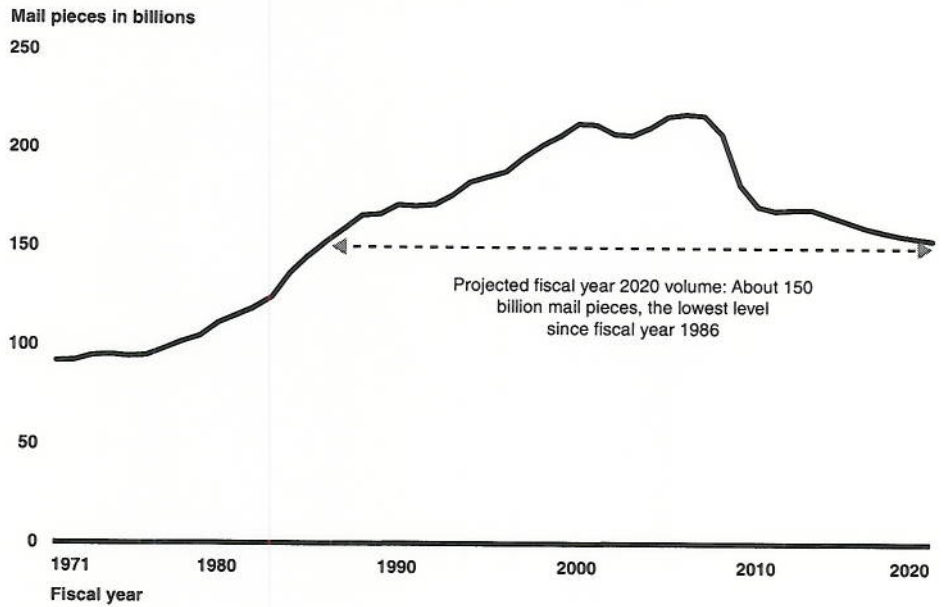
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- USPS achieved nearly \$10 billion in cost savings during this time, primarily by cutting nearly 201 million work hours. Work-hour savings were achieved by workforce reductions of over 84,000 full- and part-time employees, primarily through retirements; reduced overtime; and changes to postal operations.
 - Congressional action late in fiscal year 2009 deferred \$4 billion in payments USPS was mandated to make to prefund postal retiree health benefits.⁴

These actions, along with others to generate additional revenues, however, were insufficient to fully offset the impact of mail volume declines and rising personnel-related costs. As a result, over this 3-year period, USPS borrowed the maximum \$3 billion each year from the U.S. Treasury and still incurred record net losses, cumulatively losing nearly \$12 billion.

USPS's financial problems are likely to continue unless fundamental changes are made to address challenges in its current business model by better aligning costs with revenues. USPS projects future declines in mail volumes, stagnating revenues, large financial losses, increasing debt, and significant financial obligations. For example, total mail volume for the first quarter of fiscal year 2010 was down almost 4.4 billion pieces, a decrease of almost 9 percent over last year. For fiscal years 2010 and 2011, USPS is already projecting annual deficits exceeding \$7 billion, creating additional pressures to generate sufficient cash to meet its obligations. USPS expects to borrow \$3 billion in fiscal year 2010, which would bring its total outstanding debt to \$13.2 billion, close to its \$15 billion statutory limit, which it could reach as early as fiscal year 2011. Moreover, USPS projections through fiscal year 2020 indicate that total mail volume is not expected to return to its former levels (see fig. 1).

⁴Pub. L. No. 111-68, §164, 123 Stat. 2023 (Oct. 1, 2009).

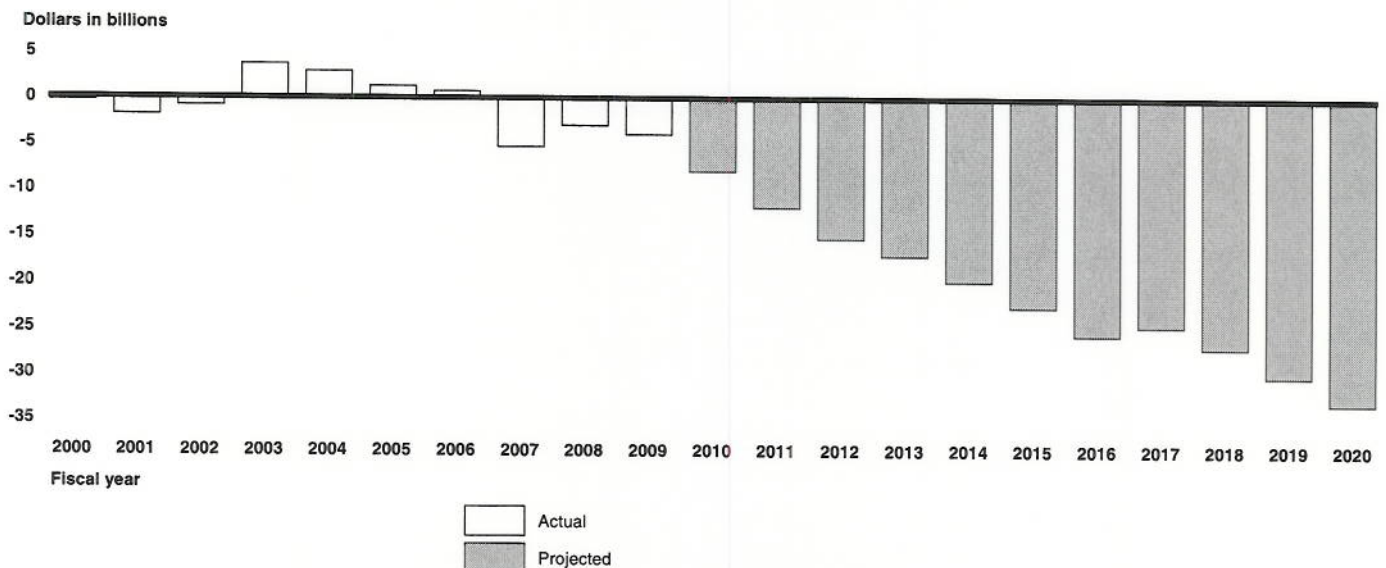
Figure 1: Actual and Projected Total Mail Volume, Fiscal Years 1971 through 2020



Source: USPS.

USPS projects that financial losses will escalate over the next decade, with cumulative losses of over \$238 billion by fiscal year 2020 if its planned cost reduction and revenue generation initiatives are not implemented (see fig. 2).

Figure 2: USPS Actual and Projected Net Income (Loss), Fiscal Years 2000 through 2020



Source: USPS.

Note: The projection for fiscal year 2010 is from USPS's Fiscal Year 2010 Integrated Financial Plan. USPS projections for fiscal years 2011 through 2020 are from its *Action Plan* and assume that (1) USPS takes no management actions beyond those in its fiscal year 2009 budget and (2) USPS's total statutory borrowing limit of \$15 billion would be increased to accommodate these losses. USPS's \$8.4 billion in cumulative net income for fiscal years 2003 through 2005 largely resulted from a 2003 law (Pub. L. No. 108-18) that reduced USPS pension benefit payments by about \$9 billion over this period.

These financial challenges highlight deficiencies in USPS's business model, which is predicated on fulfilling its mission through self-supporting, businesslike operations. The financial and operational challenges facing USPS have been exacerbated by the recent economic downturn. Because of these challenges, in July 2009, we placed USPS's financial condition on our high-risk list and testified that restructuring is needed to enhance USPS's current and long-term financial viability.⁵ We concluded in our most recent report that its business model is not viable because it is unable to reduce costs sufficiently in response to continuing mail volume and revenue declines. We continue to believe that major restructuring is necessary and not doing so will increase the risk that taxpayers and the U.S. Treasury will have to provide financial relief.

⁵GAO-09-937SP and GAO, *U.S. Postal Service: Broad Restructuring Needed to Address Deteriorating Finances*, GAO-09-790T (Washington, D.C.: July 30, 2009).

Actions Congress and USPS Can Take to Facilitate Progress toward Financial Viability

Action by Congress and USPS is urgently needed in a variety of areas to facilitate progress toward USPS's financial viability. We have identified a variety of strategies and options that can be taken to address these challenges. Some of these strategies can be completed within USPS's current authority, while others would need congressional involvement or require collaboration with unions through collective bargaining. The strategies fall into three major categories:

- reducing compensation and benefits costs,
- reducing other operations and network costs and improving efficiency, and
- generating revenues through product and pricing flexibility.

Other options that Congress may want to consider would more comprehensively restructure USPS's statutory and regulatory framework to reflect business and consumers' changing use of the mail. Although our report did not focus on whether USPS's ownership structure should be changed, we identified the following questions that could be helpful when considering this framework:

- *Mission:* What universal postal service, including mail delivery and postal retail service, is appropriate in light of fundamental changes in the use of mail?
- *Role:* Should USPS be solely responsible for providing universal delivery and postal retail service, or should that responsibility be shared with the private sector?
- *Monopoly:* Does USPS need a monopoly over delivery of certain types of letter mail and access to mail boxes to finance—in part or wholly—universal postal service?
- *Governance and regulation:* What is an appropriate balance between USPS's managerial flexibility and the oversight and accountability provided by the current governance and regulatory structure?

To facilitate progress going forward, it will be critical for USPS and Congress to reach agreement with other stakeholders on major issues that impede USPS's ability to implement actions to reduce financial losses, such as the following:

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- *Funding postal retiree health benefits:* USPS has said that it cannot afford its required prefunding payments, and several proposals have been made to defer costs by revising the statutory requirements. It is important that USPS fund its retiree health benefit obligations—including prefunding these obligations—to the maximum extent that its finances permit. In revising the requirements, it will be important to consider what is affordable to USPS; what is a fair balance of payments between current and future ratepayers; and what impact such changes could have on the federal budget.⁶
 - *Binding arbitration:* One of the most difficult challenges is making changes to USPS's compensation systems, which will be critical to its financial condition since wages and benefits represent 80 percent of its costs. USPS and its employee unions will begin negotiations for new agreements in 2010 and 2011. In this regard, the time has come to reexamine the structure for collective bargaining that was developed 40 years ago. Since that time, USPS's competitive environment has changed dramatically, and rising personnel costs are contributing to escalating financial losses. Thus, Congress should consider modifying the collective bargaining process to ensure that any binding arbitration takes USPS's financial condition into account.
 - *Realigning postal services with changing use of the mail:* As mail use by businesses and consumers continues to change, USPS has stated that it cannot afford to provide the same level of services. For example, it has estimated that costs could be reduced by about \$3 billion annually if delivery frequency is reduced from 6 days to 5 days per week, but congressional action would be needed to remove statutory requirements for 6-day mail delivery. USPS filed its proposal to eliminate Saturday delivery with the PRC on March 30, 2010. This action will allow public input on this issue and lead to a PRC advisory opinion.
 - *Generating revenue through new or enhanced products and services:* A key issue is whether USPS can make sufficient progress using the pricing and product flexibility provided in PAEA or if changes are needed. In 2009, USPS asked Congress to change the law so that it could diversify into nonpostal areas to find new opportunities for revenue growth. USPS and stakeholders we collected information from offered many options for diversification into nonpostal areas, including banking, financial, insurance, and government services, either on its own or in partnership

⁶See GAO-10-455 for a discussion of different approaches for funding USPS's retiree health benefit obligations.

with other private firms or government agencies. USPS also asked for additional pricing flexibility in a recently issued *Action Plan*.⁷ However, it is unclear what the potential impacts of such changes would be and what statutory or regulatory changes would be needed.

- *Realigning operations, networks, and workforce:* Once Congress and USPS have determined what, if any, changes should be made in the products and services that it provides, postal operations, networks, and workforce would need to be realigned. Decisions in this area will involve difficult tradeoffs related to reducing USPS's size so as to remain self-financing and keep prices affordable, versus concerns about how such realignments would affect its workforce, the value of USPS's brand, and its network of physical assets.

When we placed USPS on our high-risk list, we suggested that USPS develop and implement a broad restructuring plan that would identify specific actions planned, key issues to address, and steps Congress and other stakeholders needed to take. On March 2, 2010, USPS issued an *Action Plan* that identified seven key areas in which it would need legislative changes or congressional support. Many of the options discussed are similar to those we have analyzed and included in our recent report. USPS's plan indicates that actions within its control can close \$123 billion of this financial gap, but that actions outside its existing authority—including some involving statutory changes—will be needed to eliminate the remaining financial gap. Progress on these issues will likely take several years to fully implement once a decision is made on the scope of needed changes.

Congress, USPS, and other stakeholders need to reach agreement on the actions that should be taken, the desired operational and financial results, and the time frames for implementation. Key questions that need to be addressed include the following:

- *Universal service:* What, if any, changes are needed—that is, should delivery services be changed (e.g., frequency or standards), and should retail services be moved out of post offices to alternative locations?

⁷United States Postal Service, *Ensuring a Viable Postal Service for America: An Action Plan for the Future* (Washington, D.C.: March 2010). USPS's plan and related material are available at the following Web address: <http://www.usps.com/strategicplanning/futurepostalservice.htm> (accessed on Apr. 9, 2010).

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- *Realigning operations, networks, and workforce:* How should USPS optimize its operations, networks, and workforce to support changes in services? How quickly can this happen? How can USPS best work with its employees and customers to minimize potential disruption?
 - *New products and services:* What opportunities are there to introduce profitable new postal products and enhancements to existing ones? Should USPS engage in nonpostal areas where there are private-sector providers? If so, under what terms?

In our recent report, we stated that to facilitate progress in difficult areas, such as realigning operations, networks, and workforce, Congress may want to consider an approach similar to that used by the Department of Defense's Base Realignment and Closure (BRAC) Commission. USPS agreed with the report's key findings but raised concerns about using a BRAC-type panel and its timing. Congress has previously turned to panels of independent experts to assist in restructuring organizations that are facing key financial challenges. These panels have helped establish consensus and developed proposed legislative or other changes to address difficult public policy issues. Establishing a similar commission or control board of independent experts could provide a mechanism to assist Congress in making timely decisions and comprehensive changes to USPS's business model and operations.

In addition to establishing a panel, our report included two other matters for Congress to consider to address USPS's financial viability in the short term:

- Modify USPS's retiree health benefit cost structure in a fiscally responsible manner.
- Revise the statutory framework for collective bargaining to ensure that binding arbitration takes USPS's financial condition into account.

The current crisis presents an opportunity to act and position this important American institution for the future. The longer it takes for USPS and Congress to address USPS's challenges, the more difficult they will be to overcome.

Mr. Chairman, this concludes my prepared statement. I would be pleased to answer any questions that you or other Members of the Committee may have.

Contact and Staff Acknowledgments

For further information regarding this statement, please contact Phillip Herr at (202) 512-2834 or herrp@gao.gov. Individuals who made key contributions to this statement include: Shirley Abel, Amy Abramowitz, Teresa Anderson, Joseph Applebaum, Gerald Barnes, Joshua Bartzan, William Dougherty, Patrick Dudley, Brandon Haller, Carol Henn, Paul Hobart, Kenneth John, Anar Ladhani, Hannah Laufe, Scott McNulty, Daniel Paepke, Susan Ragland, Amy Rosewarne, Travis Thomson, Jack Wang, and Crystal Wesco.

Related GAO Products

U.S. Postal Service: Action Needed to Facilitate Financial Viability. GAO-10-624T. Washington, D.C.: April 15, 2010.

U.S. Postal Service: Strategies and Options to Facilitate Progress toward Financial Viability. GAO-10-455. Washington, D.C.: April 12, 2010.

U.S. Postal Service: Financial Crisis Demands Aggressive Action. GAO-10-538T. Washington, D.C.: March 18, 2010.

U.S. Postal Service: The Program for Reassessing Work Provided to Injured Employees Is Under Way, but Actions Are Needed to Improve Program Management. GAO-10-78. Washington, D.C.: December 14, 2009.

U.S. Postal Service: Financial Challenges Continue, with Relatively Limited Results from Recent Revenue-Generation Efforts. GAO-10-191T. Washington, D.C.: November 5, 2009.

U.S. Postal Service: Restructuring Urgently Needed to Achieve Financial Viability. GAO-09-958T. Washington, D.C.: August 6, 2009.

U.S. Postal Service: Broad Restructuring Needed to Address Deteriorating Finances. GAO-09-790T. Washington, D.C.: July 30, 2009.

High Risk Series: Restructuring the U.S. Postal Service to Achieve Sustainable Financial Viability. GAO-09-937SP. Washington, D.C.: July 28, 2009.

U.S. Postal Service: Mail Delivery Efficiency Has Improved, but Additional Actions Needed to Achieve Further Gains. GAO-09-696. Washington, D.C.: July 15, 2009.

U.S. Postal Service: Network Rightsizing Needed to Help Keep USPS Financially Viable. GAO-09-674T. Washington, D.C.: May 20, 2009.

U.S. Postal Service: Escalating Financial Problems Require Major Cost Reductions to Limit Losses. GAO-09-475T. Washington, D.C.: March 25, 2009.

U.S. Postal Service: Deteriorating Postal Finances Require Aggressive Actions to Reduce Costs. GAO-09-332T. Washington, D.C.: January 28, 2009.

U.S. Postal Service: USPS Has Taken Steps to Strengthen Network Realignment Planning and Accountability and Improve Communication. GAO-08-1022T. Washington, D.C.: July 24, 2008.

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U.S. Postal Service Facilities: Improvements in Data Would Strengthen Maintenance and Alignment of Access to Retail Service. GAO-08-41. Washington, D.C.: December 10, 2007.

U.S. Postal Service: Mail Processing Realignment Efforts Under Way Need Better Integration and Explanation. GAO-07-717. Washington, D.C.: June 21, 2007.

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