



**TESTIMONY OF
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BEFORE THE
COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE
NOVEMBER 5, 2003**

Chairman Collins and members of the Committee, I welcome this opportunity to meet with you today to discuss the important issue of postal, legislative reform. This is a subject that is critical to the continued, long-term ability of the United States Postal Service to provide affordable, universal mail service to every individual, home and business in America.

In particular, I look forward to discussing some of the recommendations of the President's Commission on the United States Postal Service.

As Postmaster General, I am grateful for the Commission's efforts. I am pleased by the Commission's acknowledgement that the Postal Service's Transformation Plan is making substantial progress in adapting to an uncertain future. Since assuming the role of Postmaster General, I have made the Plan the central focus of the Postal Service.

And I am particularly satisfied that so many of the Commission's recommendations are consistent with strategies that we are already pursuing as a part of our transformation efforts. Clearly, the Postal Service's Transformation Plan is taking us in the right direction. And I appreciate the support and guidance of this Committee as the Postal Service worked to create the Plan.

While the Transformation Plan became our organizational vision in 2002, the ongoing process of transformation began long before then through our breakthrough productivity initiative. The year 2000 marked the first of a record four straight years of increases in total factor productivity. We have reduced our career employee complement by 70,000 from its peak level in 1999. We have delivered \$5 billion in cost savings since 2000. We have established pay-for-performance systems for managers and executives. We have brought service and customer satisfaction to historic performance levels. We are aggressively managing the business. This will not change.

In addition to the Transformation Plan strategies that have contributed to these successes, the recent legislation adjusting the Postal Service's payments to the Civil Service Retirement System helped us to achieve a welcome and needed level of financial stability.

Without the correction provided by this legislation, the Office of Personnel Management found that the Postal Service could have overpaid its obligation by \$105 billion, costs that would otherwise have been borne by every user of the mail through the price of postage. We are particularly grateful for the understanding and cooperation of the Chairman and this Committee for your prompt action in addressing this problem.

By immediately reducing costs related to funding the Civil Service Retirement System, this legislation will allow us to hold rates steady until 2006. This legislation has contributed to our ability to reduce outstanding debt by more than one third – from \$11.1 billion to \$7.3 billion – in fiscal year 2003. We will continue to take advantage of the new CSRS payment schedule to reduce debt even more this fiscal year.

Yet, the same legislation presents very definite challenges.

First, the legislation shifted the responsibility of funding CSRS retirement benefits earned by postal employees while they served in the military from the Treasury to the Postal Service. The General Accounting Office estimates that this transferred an obligation of more than \$27 billion from taxpayers to postal ratepayers. Of this amount, \$17 billion represents retroactive payments of funds (including imputed retroactive interest) already provided to annuitants by the Treasury between 1971 and 2002. Except for the Postal Service, in all other cases, these costs continue to be paid through general appropriations. The Postal Service does not receive general appropriations: our operations are funded by the revenue generated by the sale of postal products and services. These military retirement costs have no connection to the operation of the Postal Service or to the services rendered to our customers now and in the future. In fact, more than 90 percent of that financial obligation is the result of military service performed before the Postal Service was created. It includes service in World War II, Korea and Vietnam.

The President's Commission recommends that military service costs not be borne by the Postal Service. We agree with the Commission on this issue, as we indicated in the report which we provided in compliance with your requirement in the reform legislation. We look forward to working with the Committee as you continue your consideration of this issue.

That legislation also asked the Postal Service for its proposals regarding the use of the "savings" resulting from the act, beginning in 2006. Those "savings" would be placed in an escrow account pending Congressional authorization about how they would be used.

I would like to take a moment to explain these "savings." They represent the difference between the Postal Service's new CSRS payment schedule and the old. They represent an adjustment of payments, costs we will not have to pay in the future. But simply because we will not be liable for these costs in the future, does not mean that there will be a reserve of actual cash waiting to be diverted to other purposes. Rather than building cash, the "savings" are used to fund normal inflationary cost increases such as COLA's and general pay adjustments required by collective bargaining agreements, increased health care benefit expenses for employees and annuitants, and growth in non-personnel expenses for fuel, utilities and materials.

For the period from 2003 through 2005, there are actual funds available – savings – to use for other purposes. This is because the postage rates now in effect were computed based on our former, higher CSRS payment schedule. A percentage of the price of every postage stamp has been earmarked for those payments. And, as the law requires, today's savings are being used to reduce debt in 2003 and 2004 and to hold postage rates steady through 2005.

But by 2006 inflationary cost increases will have whittled away the financial benefit of lower CSRS payments; even without the escrow requirement, we expect that we will have to raise rates in 2006. With the escrow requirement, postage rates will have to rise even more than is necessary to reflect inflation – some have suggested that the increase would be in the double digits. This is because the new rates would have to generate the revenue to cover what is being called the "savings," the difference between the old and new CSRS funding schedule.

And, with a continuing, future escrow-funding requirement, we would have to continually increase rates frequently simply to fund the escrow account. And, as I mentioned, this "hands off" fund could be spent by the Postal Service only with Congressional authorization. Thus without further legislation, the benefits enjoyed by every mail user in the nation – business, nonprofit and consumer – would evaporate as soon as 2006 through the higher rates required to fund the escrow account. This would put postal customers back where they started from before the legislation was enacted – reinstating the very over-funding the legislation was designed to correct.

We propose that the escrow account be eliminated.

We have also offered two alternative proposals if – and only if – the escrow requirement stands.

First, if the \$27 billion CSRS military funding requirement is transferred back to the Treasury, the Postal Service would have fully funded and, in fact, over-funded its CSRS payment obligation by \$10 billion. We would then be in a financial position to pre-fund retiree health benefit obligations on a current basis for all employees and retirees.

Our second proposal is based on the CSRS military funding requirement remaining an obligation of the Postal Service. If that is the case, the Postal Service proposes that the funds placed in the escrow account be used to begin pre-funding postretirement health benefit costs for newly-hired Postal Service employees.

We have provided our comments on these issues to Congress, the Administration and the General Accounting Office. GAO is reviewing our proposals and will provide a written evaluation to Congress by November 29. Congress will then have 180 days to revisit the issue of the escrow account.

In the near term, the CSRS legislation has resulted in a welcome period of financial stability. Within that context, we have the opportunity and the obligation to develop the right solutions to the challenges facing the nation's mail system so that every family and every business in America continues to enjoy – and benefit from – affordable, universal mail service.

Many – in the Postal Service, the mailing community, and in Congress – have long recognized that the basic business model which guides the operation of America's mail system is becoming increasingly disconnected from today's reality. It is outdated and inflexible. The Postal Reorganization Act that created today's Postal Service in 1970 was predicated on the assumption – valid for most of the last 33 years – that continually growing mail volume would result in continually increasing revenue. That revenue, in turn, would be sufficient to cover the costs of an expanding service network. This is no longer the case.

We are pleased that the President's Commission has reached a similar conclusion. The facts speak for themselves.

Including our preliminary estimate for fiscal year 2003, mail volume has declined in each of the last three fiscal years, dropping close to six billion pieces from its peak. During the same three-year period, the number of addresses we serve increased by 5.2 million.

This combination of factors – declining mail volume contrasted with the costs of a still-growing service network – resulted in a net loss in two of the last three years. Cumulatively, those losses amounted to \$2.3 billion.

While our financial results for Fiscal Year 2003 were positive, with an unaudited net income of approximately \$3.9 billion, this reflects the impact of legislation that reduced the Postal Service's obligation to the Civil Service Retirement System.

Of course, a number of external factors contributed to mail volume losses since 2001. These included the 9/11 terrorist attacks, the use of the mail for bioterrorism and, most significantly, the effects of a difficult economy.

Profound structural changes are also at work. These include the increasing use of electronic communications for transactions that, in the past, had almost universally taken place through the mail. The robust growth of private-sector delivery services – from packages to time-sensitive communications – has also altered the competitive landscape. We do not expect that these factors will necessarily result in absolute mail volume loss in the foreseeable future. But they will, at the very least, contribute to a diminished rate of mail volume growth as our delivery infrastructure – and its associated costs – continues to expand. This will place extreme pressure on our bottom line. Significantly, volume trends indicate that First-Class Mail, which provides the greatest contribution to supporting system overhead, may continue its decline.

To that end, President Bush, in December 2002, created a Commission to examine the Postal Service and to prepare a report defining a proposed vision for its future and recommending legislative and administrative reforms needed to ensure the vitality of postal services for the American people.

I thank the Administration for its willingness to take on this critical public policy challenge sooner rather than later. In particular, I would like to recognize the efforts of Peter Fisher, former Under Secretary of the Treasury for Domestic Finance, for his role in implementing the President's mandate. His guidance resulted in a Commission that took the time to understand the scope and complexity of the Postal Service, recognize its critical role to the nation, and hear from representatives of every group with an interest in the future of the nation's mail service.

Co-Chairs James Johnson and Harry Pearce – and all of the Commissioners – are to be commended for their focus and dedication to this task. They understand the forces that are threatening the ability of the Postal Service to succeed in a new century – one with communications options unheard of just a few years ago. They understand the need to define a new business model to protect the ability of the government to provide this vital service without undue expense to taxpayers or to postal ratepayers. Most importantly, they understand the need to act before there is a crisis that imposes hardship on the public.

To some observers, a recognition that the Postal Service has been on a path of continuous improvement, can lead to the conclusion that no significant change is necessary. The need for change may not become apparent to everyday mail users until the inflexibilities of our dated business model begin to affect service and the price of postage. We cannot afford to let this happen.

In many areas, we accept the Commission's recommendations, particularly where its report calls for continuing the efforts initiated through our Transformation Plan. We will continue to move forward on them.

We will continue the pursuit of strategic partnerships with the private sector where they help us enhance efficiency, reduce costs or improve service. Areas under review include mail transportation, retail operations, delivery service, and many other activities that support our core business.

We will continue to work with the mailing industry to encourage and support the expansion of worksharing where it makes sense. This provides mailers with strong financial benefits encouraging the use of mail and contributes to more efficient operations for the Postal Service.

We will continue more innovative approaches to how we buy products and services. Our transition to master buying agreements in key areas has saved \$200 million in fiscal year 2003 alone. We will pursue every opportunity to benefit by similar agreements in as wide a range of buying activities as possible. Within the scope of existing legislation, we will also revise our purchasing regulations to reflect corporate best practices that can improve our operating and administrative practices and ensure that we receive maximum value with every purchase.

We accept the Commission's view that the Postal Service should enhance its financial reporting. While the Commission notes that, in many respects, our reporting often exceeds what is required of Federal agencies, the Commission recommends that our reporting match the level of disclosure offered by our corporate peers. Accordingly, we will continue to transition our financial reporting to satisfy standard Securities and Exchange Commission requirements, where those requirements make sense when applied to a non-publicly traded, non-stockholder owned company.

We agree with the Commission that electronic technology offers a way to increase the value of the mail at every step – from acceptance to delivery – for the sender, the recipient and the Postal Service. Our Intelligent Mail initiative and its "One Code" vision will be instrumental in achieving many of the advances – both in processing efficiency and providing information for mail users – envisioned by the Commission. We must give appropriate attention, however, to the concerns of our customers, including those regarding privacy protection, which may be raised by the recommendation that every mailpiece bear a unique identifier.

The Postal Service shares broad agreement on many of the critical, structural issues treated in the Commission's report.

The report recognizes that the Postal Service requires additional flexibility if it is to take advantage of corporate best practices that are necessary for long term success in serving the nation. In short, management needs the flexibility to manage.

We agree with the Commission that the establishment of a rate-ceiling or price cap offers some additional pricing flexibility not provided by our present cumbersome, time-consuming, litigious pricing regime. Over the last few years, we have seen a growing consensus, within the mailing community and through previous postal legislative reform efforts, for a pricing structure that will increase rate predictability for customers and provide management with additional flexibility to respond to market needs.

A properly constructed price cap proposal can accomplish both of these goals. But we caution that such a cap must be carefully constructed so that it succeeds in driving maximum operational efficiency, but does not undermine the legitimate financial needs of the organization.

We agree that there should be separate processes for pricing non-competitive and competitive products and services. However, we believe that more work needs to be done to ensure that the definitions of non-competitive and competitive products carefully reflect marketplace reality.

The Postal Service and the Commission agree the Postal Service should have the opportunity to retain earnings – as requested in our Transformation Plan. This would provide a revenue stream that could finance capital expenditures and "smooth out" business cycle impacts on overall financial performance. Yet there must be safeguards so that severely limiting price caps do not serve as an artificial barrier to achieving retained earnings, and that retained earnings are sufficient to achieve their purpose.

We agree with the Commission that the letter and mailbox monopolies are essential to support a universal service mandate. The Commission's report would give a Postal Regulatory Board the authority to examine and modify these monopolies from time to time. We believe any modification must be in the public interest, must not undermine the Postal Service's ability to maintain universal service, and must protect the security and privacy of what is placed in the mailbox.

We agree with the Commission, generally, in its description of the Postal Service's core mission: offering products and services directly related to the delivery of letters, newspapers, magazines, advertising mail and parcels. But we do have concerns about the Commission's recommendation that the Postal Service be limited by statute to only those activities. We are facing an uncertain future. The Commission's own projections call for a mail volume decline of five percent by 2017, and, for that same year, a Postal Service deficit of \$8.5 billion. We strongly believe that it is necessary for the Postal Service to have the flexibility to pursue appropriate new revenue streams to protect our ability to provide universal service.

We agree with the Commission that the Postal Service must have the ability to alter its retail and processing networks to meet changing customer needs, provide increased access and achieve greater operational efficiency. Yet the proposed Postal Network Optimization Commission could take away the Postal Service's existing authority to better integrate and align its network.

While the new process offers many attractive features, including providing for valuable input from affected stakeholders, including Congress, it should not exclude the Postal Service from the decision-making process. Clearly, the expertise gained from day-to-day operation of the Postal Service's network should play a substantive role in any decisions to change that network, including any decisions to consolidate or close processing facilities. Despite the rationale for its establishment, we believe that the proposed network optimization process may lead to office-by-office or facility-by-facility decisions, rather than focusing on the efficient operation of the network as a whole.

We agree with the Commission that the Postal Service, its employees and the unions that represent them would benefit by a more efficient collective-bargaining process. We also agree that addition of a mandatory mediation step – if negotiations have not resulted in a new agreement – could help forge a final resolution or limit the issues that must be addressed if interest arbitration becomes necessary.

We agree with the Commission that collective-bargaining should include the ability of the parties to negotiate for benefits as well as wages. Because it is not our intention to reduce the benefits already enjoyed by current and retired Postal Service employees, benefit negotiations would affect only eligible employees entering the Postal Service following the conclusion of negotiations.

In short, on many key issues, the Postal Service and the Commission have a basic level of agreement. This is an encouraging beginning. At the same time, as I have pointed out, many of the challenges are in the details.

As an example, in the area of governance, the Commission recommends significant changes to our governing board. The Governors of the Postal Service are today appointed by the President with the advice and consent of the Senate. The law requires that no more than five may belong to the same political party. This has allowed the Postal Service to enjoy bipartisan oversight for the last three decades.

We are concerned that the Commission's proposed new Board of Directors could change this. The President would appoint three Board members. They, in turn, would select the first eight independent Board members, with the concurrence of the Secretary of the Treasury. After that, independent members would be selected by the Board as a whole, with the concurrence of the Secretary of the Treasury. There would be no limits on the political affiliation of Board members, and only the President or the Secretary of the Treasury could remove them. This could result in a highly-partisan Board. Moreover, the Senate's current statutory role of "advice and consent" in connection with Board appointees would be eliminated.

Despite the areas in which we have questions or concerns with the Commission's recommendations, the Postal Service fully understands and accepts that with an increased level of management flexibility comes an increased level of oversight. This provides the necessary balance to protect the public interest.

The Commission proposes that this oversight be largely provided by a new Postal Regulatory Board, with discretionary policy authority in a wide range of areas, to replace the current Postal Rate Commission, which has a more limited mandate.

We understand the rationale for the discretion the Presidential Commission has defined for the Postal Regulatory Board. Yet regulators are normally required to operate within limits and guidelines. Regulated private companies and their shareholders have legal protections against arbitrary action by the regulator that the Postal Service cannot have as a government institution. At the least, there should be standards drawing a clear line between what is appropriately a managerial function within the oversight of the Governors or Directors, what is a regulatory function committed to the regulator, and what is a public policy function reserved to the nation's lawmakers.

For instance, the Postal Regulatory Board can revisit the vital national issues of the postal monopoly and universal service. From the perspective of the Postal Service, these are clearly issues of broad public policy. They are not regulatory issues. Without defined limits or guidelines, the regulator could conceivably limit the monopoly in such a way as to jeopardize universal service or even redefine the scope of the nation's mail service itself.

Similarly, the Commission's recommendations would remove the determination of how much money is needed to run the nation's postal system from the operators – those with the day-to-day responsibility of running the postal system – and transfer it to the Postal Regulatory Board. This would occur through the new rate-setting mechanisms recommended by the Commission. At the very least, those provisions should recognize that the Postal Service is a labor-intensive industry which operates as part of our economy's service sector.

The powers of the proposed Postal Regulatory Board could also affect the outcome of the collective-bargaining process. The Postal Service has been, and continues to be, a strong supporter of collective bargaining. This process of give and take assures that the interests of our employees – and the unions that represent them – are considered within the larger picture of the Postal Service's financial situation and the needs of our customers. But by determining the range within which wages may be negotiated, the Postal Regulatory Board could impede the ability of the parties to successfully negotiate agreements.

Since the advent of collective bargaining in the Postal Service in 1971, there have been voices from all sides on whether postal wages were or were not comparable with private-sector wages, as required by current law. The Postal Regulatory Board would be charged with making a "comparability" determination that would presumably end that argument.

But the issue of comparability is dynamic and depends on economic factors and job skill requirements that can change with time and circumstances. A wage comparability determination made by an independent Postal Regulatory Board may inform periodic contract negotiations, but it is important to permit the Postal Service and its unions to engage in direct negotiations which balance the needs of all parties without requiring strict adherence to the results of any specific comparability determination.

Speaking to you today, I am reminded of the efforts in the late 1960s to define a new and better model for the postal system in the United States. At a hearing not unlike this one, one of my predecessors, Postmaster General Larry O'Brien was asked by Representative Tom Steed, Chairman of the House Appropriations Subcommittee:

General, would this be a fair summary: that at the present time, as manager of the Post Office Department, you have no control over your work load, you have no control over the rates of revenue that you are able to bring in, you have no control over the pay rates of the employees that you employ, you have very little control over the conditions of the service of these employees, you have virtually no control, by the nature of it, of the physical facilities that you are forced to use, and you have only a limited control at best over the transportation facilities that you are compelled to use . . . This is a staggering amount of “no control” in terms of the duties you have to perform.

Postmaster General O'Brien agreed.

And, in reviewing the details of some of the Commission's recommendations, particularly those related to the Postal Regulatory Board, I feel somewhat like Larry O'Brien did. In return for some basic elements of rate-setting flexibility, the Postal Service is asked to cede a staggering amount of control in areas that – for both government and the private sector – are traditionally at the core of the decisions and responsibilities of management.

The mail is today – and will remain for many years to come – a critical element of our nation's infrastructure. We believe there is a proper balance between increased flexibility for the Postal Service and an effective level of independent oversight. In achieving that balance, we have the opportunity to create a legacy of customer-responsive service that serves everyone in our nation equally – and equally well.

I am encouraged by the interest this Committee has demonstrated by holding a series of hearings to explore the recommendations of the President's Commission on the Postal Service. The Commission has added a new voice to the important conversation about the future of America's mail system. It is not a conversation that can be limited to the Postal Service and its industry partners. It is a conversation that will result in broad public policy decisions that will affect every family, every business and every community in the nation. For that reason, the decisions that are made must be in the public interest and they must reflect the will of the Congress and the Administration.

Mr. Chairman, I have been asked for my vision of the Postal Service. We need a Postal Service that is incented to improve service and productivity. We need a Postal Service that is given the flexibility to reduce costs. We need a Postal Service that has the ability to implement rates that are responsive to the market and that will mitigate large rate increases that have become counterproductive. We need a Postal Service that has the ability to work with and treat customers as individuals with individual needs. We need a Postal Service where our products, services and systems are available to those we serve where they are located, not just where there are Post Offices. Finally – and importantly – we need to retain a motivated and informed workforce to provide universal service to every home and business in the nation.

I look forward to working with this Committee and with the Congress to identify the business model that will enable the Postal Service to serve everyone in America, today and far into the future.

I pledge to provide the cooperation, the resources and the support that will enable us to do that. We cannot afford to do otherwise.

Thank you. I will be happy to answer any questions you may have.

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