UNITED STATES POSTAL SERVICE ®

STATEMENT OF DAVID FINEMAN, CHAIRMAN
UNITED STATES POSTAL SERVICE BOARD OF GOVERNORS
BEFORE THE
SPECIAL PANEL ON POSTAL REFORM AND OVERSIGHT
COMMITTEE ON GOVERNMENT REFORM
U. S. HOUSE OF REPRESENTATIVES
JANUARY 28, 2004

Good afternoon, Mr. Chairman and Members of the Special Panel.

I appreciate the interest of this committee in assuring the continuance of affordable universal mail service for each and every American. Thank you for the opportunity to talk with you about the critical issue of comprehensive legislative reform for the United States Postal Service.

As you know, the Postal Service Board of Governors directs the exercise of the power of the Postal Service. It establishes strategic policies, basic objectives, and long-range goals for the Postal Service. We take these responsibilities very seriously.

I have had the pleasure of being a member of the Board of Governors of the United States Postal Service since 1995. Over the course of those nine years, I have worked closely with my fellow governors to conscientiously carry out our legal mandate to “direct and control the expenditures and review the practices and policies of the Postal Service”. I also came to realize early on that the law under which we operate is both antiquated and inefficient. I have had the pleasure of getting to know many of you and your staff as I have worked with you towards bringing about change to this law.

I have also come to appreciate the value of mail service to the American people and the role it plays in making the US economy the greatest in the world. I am proud of the thousands of dedicated Postal employees who manage to get the mail delivered regardless of the obstacles faced. We have faced some significant challenges in the last few years, and I want to thank every member of this Panel, the General Accounting Office, and the Administration for their assistance in helping us address them.

In 2003, the United States Postal Service set records in service, productivity and customer and employee satisfaction, while also maintaining universal mail service and generating a positive bottom line for the business.

We closed the year with a net income of $3.9 billion, reflecting both our success in managing costs and improving efficiency and the positive effects of the Civil Service Retirement System funding reform legislation.

An analysis by the Office of Personnel Management found that, without a change in our payment schedule, the Postal Service would overpay its obligation to the Civil Service Retirement System by $105 billion. Quick action by Congress and the Administration resulted in legislation to avoid this overpayment.

The savings available through the new law helped us reduce outstanding debt by more than one third, from $11.1 billion to $7.3 billion, and make it possible for us to continue reducing debt in 2004 and holding postage rates steady until at least 2006.

But these successes are masking a basic flaw in the business model upon which the Postal Service was founded. The assumption that growth in mail volume will provide sufficient revenues to meet the cost of providing universal service to an ever-growing number of delivery points is no longer valid.

The goal of the 1970 law creating the modern Postal Service was to provide universal, affordable mail service to everyone in America while maintaining a focus on self-sufficiency and the bottom line. For many years, the legislation has been very successful. Over the course of the past three decades, postage rates have risen at about the rate of inflation and the Postal Service has been modernized to meet the changing service needs of businesses and the public.

However, the Postal Service faces a major structural change in the way Americans conduct business. Electronic alternatives to hard copy mail are becoming increasingly acceptable to the public and will continue to divert significant portions of the mail stream away from the Postal Service and onto the Internet.

There is evidence that this diversion has begun. Significant amounts of business correspondence have been diverted from the mail stream, and bills, payments and other financial transactions that constitute the bulk of First-Class Mail volume are vulnerable to further diversion.

First-Class Mail volume declined for two years in a row and the decline is accelerating. From a peak of 104 billion pieces in 2001, First-Class Mail declined by 1 billion pieces in 2002 and another 3 billion pieces in 2003. While this decline is partially attributable to sluggish economic growth and perhaps the lingering effects of the bioterrorist attacks of 2001, electronic diversion is a factor as well.

For the first time since the Postal Service was reorganized 34 years ago, First-Class Mail volume was less than 50 percent of total mail volume. Total mail volume was 202 billion pieces, with First-Class Mail registering only 99 billion pieces.

Standard Mail, which is largely advertising, reached its highest share of the total ever in 2003, at 45 percent. While the prospects of growth in advertising mail volume are good, the contribution margin obtainable from this very price-sensitive category is much lower than that for First-Class Mail. It takes about three new pieces of Standard Mail to make up for the loss of one piece of First-Class Mail.

The financial problems presented by declining volume and changes in the mail mix are exacerbated by the need to serve an expanding delivery network. Although the total amount of mail we delivered declined between 2002 and 2003, the number of addresses served increased by 1.9 million. While we deliver to 5.4 million more addresses than in 2000, the amount of mail we delivered has declined by 5.7 billion pieces since that time.

Remember, our business model was designed around the premise that increasing volume will pay for an ever-expanding delivery network.

As a result, we are challenged to find new expense reductions and revenue growth to compensate for the decline in this historic funding source.

But the decline in volume and the change in the mail mix took away $668 million in revenue contribution last year alone. This is the same as adding an extra one percent to our cost base.

Essentially, the volume of First-Class Mail and the number of delivery points are moving in opposite directions. Since 2001, while First-Class Mail volume decreased, our delivery network has expanded by 3.7 million new delivery points. We absorbed these deliveries through productivity increases rather than hiring the equivalent of 4,000 new carriers each year, purchasing new vehicles, and adding facilities space.

We expect this delivery point growth to continue for the indefinite future. The Bureau of the Census reported housing starts in August 2003 at a seasonally adjusted rate of 1.82 million, while Harvard University's Joint Center for Housing Studies reported that housing production in the current decade is expected to "exceed the 16.6 million units built and manufactured between 1991 and 2000" due to "increasing household growth, strong demand for second homes and better balance in rental markets."

Additionally, strong immigration, younger members of the baby-bust generation living on their own, aging baby-boomers purchasing second homes and shifts in family composition contribute to a projected average annual demand for 1.7 million new housing units.

There is another issue as well. It is very labor intensive to deliver the mail. And salaries and benefits are our biggest expense. This expense is determined by the number of employees, the number of hours they work, their rates of pay and the benefits they receive, such as health and retirement benefits.

Our expenses are also affected by increases in the premiums for the health plans of our retired employees. A significant source of expense growth in recent years has been the inflation in health benefits. Federal Employee Health Benefit Program premiums increased 13.3 percent in January 2002 and by 11.1 percent in January 2003.

Premium increases averaging 10.6 percent are scheduled for January 2004. This has translated to health benefit cost increases for the Postal Service of $471 million in 2002 and another $471 million in 2003.

Each one of these issues presents challenges to us, given the limitations of our current mandate. Combined, they offer a daunting prospect for the viability of our business model.

Nonetheless, the Board of Governors has the legal obligation to manage within the constraints of the current business model, so that is what we have been doing – and in my opinion, doing quite well.

We are managing for results. We have asked management to focus on three key strategies: improving operational efficiency, adding value for our customers, and enhancing our performance-based culture.

With the help of management, Congress, and stakeholders, we identified each of these strategies in the Transformation Plan we developed in 2002. We know the Postal Service must continue to change to meet the needs of a changing nation. The Transformation Plan is helping us do that.

Regardless of the long-term proposals out there right now, our Transformation Plan remains our guide to doing all we can within the current law to increase the value of the mail, make it more effective than ever and assure its future.

We have taken other steps to take full advantage of all the flexibility granted to us by current law. Let me give you some examples.

First, let's touch on our fiduciary responsibilities. We have an Audit and Finance Committee to review the soundness of accounting and internal control practices and major financial statement accruals for the organization. The Committee also monitors financial performance, debt levels and cash management.

So, in February of 2001, when the Chairman of the Board's Audit and Finance Committee reported that the trends in Postal Service finances were "alarming and unacceptable…", we quickly moved to re-examine how this organization was conducting business on all levels.

Management was directed to temporarily freeze all new facility commitments, reduce planned new facility commitments for the year by $1 billion, and limit future capital commitments to levels that could be funded from cash flow.

In the last three years capital commitments have been limited to those projects that have an acceptable return on investment, are required by law, or have been necessary to insure customer and employee safety. New commitments, which had averaged $3.5 billion per year in the five years leading up the temporary freeze, have averaged $1.6 billion per year in the three years since.

These measures have worked. Cash flow has been adequate to fund capital spending in the last three years and debt has fallen.

The most important way in which the Board provides direction to the Postal Service is through the selection of the Postmaster General. In selecting Jack Potter, a career operations veteran to lead the organization, the Board sent a clear signal that service performance, cost control and productivity improvement were the priorities.

The organization responded. Service performance scores climbed to record levels and the number of our career employees declined by 24,000 in 2003. We plan an additional reduction of 25 million work hours in 2004, which translates to as many as 11,000 fewer career positions.

Best of all, we have reduced these positions through attrition, voluntary retirements, vacancies and reassignments. No employees were laid off.

The Board also decided that management should give greater emphasis to focusing on its core strengths. One area of particular concern was e-commerce. We began a re-evaluation of all e-commerce business plans.

After reviewing the financial performance and expectations for these plans, as well as their alignment with the Postal Service's core business, all but one of our e-commerce ventures were discontinued or realigned.

At the time we began our review in February 2001, e-commerce spending was $33 million annually, producing gross revenue of only about $2 million. Today, the Postal Service is spending less than one million dollars a year on e-commerce, with projected gross revenue of $5 million.

The lesson is clear. We don't have the luxury of taking our eye off the ball. We must remain focused on our core business. This remains a priority for the Board in all its strategic policy and fiduciary decision-making.

The Board's focus on the bottom line has strengthened financial management within the Postal Service. The spread between long-term and short-term interest rates last year created an opportunity to refinance our debt, reducing our average interest rate from 5.1 percent to 1.1 percent.

As a result, we saved $62 million in interest in 2003. And, we expect to save an additional $336 million in 2004.

We are also enhancing existing products and services – and expanding access and convenience to postal services. Our popular website, USPS.com, is a great example of this, offering access to information, stamps and one of our most successful new offerings, Click-N-Ship.

With Click-N-Ship, customers can create and print mailing labels from their home computer — with or without postage — and carriers will pick the packages up at the customer's home.

We will be rolling out self-service kiosks called Automated Postal Centers this year as well. These kiosks will let customers buy stamps and postal products just as ATMs enable customers to conduct self-service banking. The goal of these efforts is to promote ease-of-use for our customers. The easier we make it for them to use our services, the more of our services they are likely to use.

There is another area where the Board has asked management to take a long, hard look at current practices – the vast network of facilities and transportation infrastructure that has developed over the years.

The opportunity to consolidate operations and streamline our network represents a significant cost reduction opportunity. A leaner plant network would drive transportation and facility costs down. That benefits everyone.

Along the same lines, the Postal Service must be allowed room to implement infrastructure changes including – but not limited to – changes in the number and location of post offices and processing plants, and changes in our transportation networks. That simply makes good business sense.

In this instance and the others I have mentioned, the Board provided leadership and support to an able top management who effectively addressed a number of difficult problems. We are fortunate to have the management team we do as we face the challenges ahead of us.

But let's be clear about this. The combination of declining First-Class Mail volume, increasing delivery points, and expanding benefits costs has put the Postal Service into a box which no amount of good management, cost cutting, or improved efficiency can get us out of. We can't get out of the box because the current business model won't allow us to.

Once again we need your help.

The time is now to provide the Board of Governors and postal management with new tools to meet the new business environment it faces. We cannot wait until the Postal Service is in such financial crisis that drastic service or delivery reductions are our only option.

Each year, as we aggressively pursue additional improvements, the margin of return becomes smaller as efficiency increases. Essentially, the more we improve our efficiency, the less room there is to make up for the gap caused by the fixed costs inherent in our current business model.

We must find new ways to give postal management the modern business tools it requires to keep the Postal Service viable in the 21st century. We must be freed from the legislative shackles of three decades ago.

We have been advocating this position for some time now. As previously mentioned, I have personally worked with many of the members of this Panel as legislation was developed to address these issues.

In March of 2001, the Board of Governors sent a letter to Congress and the President specifically stating the need for significant statutory reform in pricing and labor flexibility. The letter stated: "We see alarming trends that seriously threaten the future of America's mail service… Without change to our regulatory framework, universal service will be difficult to maintain. We foresee rapidly rising rates and reduced service if legislative reform is not enacted promptly…"

That is why we were so pleased by the creation of the President's Commission on the United States Postal Service. During the eight months that the nine-member bipartisan commission held public meetings and met with stakeholders, we provided the Commission with a great deal of information and documentation about our organization's needs and concerns. The Postmaster General and I testified before the Commission. Other Postal Service leaders testified in detail about their areas of expertise as well.

The Commission presented its findings in July. It offered recommendations for change in several key areas: the Postal Service business model, private-sector partnerships, technology and workforce. In December, the President publicly urged Congress to enact postal reform legislation based on five principles that were in the Commission's report.

We agree with the goals of these five principles – Best Practices, Transparency, Flexibility, Accountability, and Self-Financing. In many ways, they mirror our Transformation Plan for the Postal Service.

The President's Commission also said the Postal Service should set the standard for financial transparency by which all other Federal entities are judged. We agree.

In fact, last August, at the Board's direction, the Postal Service began to enhance the transparency of its financial reporting. Our 2003 Annual Report, which was issued in December and is posted on our web site, includes enhanced disclosure in the footnotes and the Management Discussion and Analysis section. In addition, in the first quarter of Fiscal Year 2004, the Postal Service began to publicly report, on its web site, significant events in accordance with SEC Form 8-K reporting requirements.

We will achieve greater financial transparency in February with the issuance of our Quarter 1, Fiscal Year 2004 Financial Report. Consistent with SEC Form 10-Q, this report will include an enhanced Management Discussion and Analysis section and expanded financial statements.

And, this month, I, along with other members of the Board of Governors and senior Postal Service officers, discussed the topic of annual disclosure as they are reported through SEC Form 10-K. In the coming months, we will complete plans to further enhance our annual financial reporting.

As we look ahead, the Governors of the Postal Service need additional flexibility in directing the activities of the Postal Service. The Postal Service's ability to adjust its retail network is constrained by current law. We have a burdensome rates process. We are being asked to operate in a very competitive marketplace without the ability to negotiate prices and service with our major customers.

We cannot be asked to conduct ourselves in a businesslike manner when the tools to do so are not available to those running the business.

We fully understand that with an increased level of management flexibility must come an appropriate 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 President's 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 Board of Governors, these are clearly issues of broad public policy that should be resolved as part of our management responsibilities, as determined by Congress.

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.

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.

The Commission also recommended significant changes to our governing board. I cannot agree with all of their recommendations, and I want to tell you why.

Today, the Governors are appointed by the President with the advice and consent of the Senate. They serve staggered nine year terms, and by law, no more than five members may belong to same political party. This structure has allowed the Postal Service to enjoy bipartisan oversight and consistent governance of this $68 billion national service provider. We are concerned that the Commission's proposal for a new Board of Directors could change this.

Under the Commission's recommendations, the President would appoint three Board members, who would then 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, again with the concurrence of Secretary of the Treasury. But there would be no limits on the political affiliation of Board members. In addition, the proposal allows the President or the Secretary of the Treasury to remove directors.

My concern is that if enacted as proposed the Senate's statutory role of "advise and consent" would be greatly diminished. The lack of party affiliation requirements and the ability of the President and Secretary of the Treasury to remove members of the Board could potentially result in highly-partisan Boards in the future.

Rather than becoming more impartial and businesslike, a Board of Directors as envisioned by the Commission could be less impartial, less knowledgeable, and possibly more political.

From previous testimony, you know that the Board of Governors is on record in favor of reform of the current ratemaking structure.

The current system is cumbersome and expensive, and it pits the entire postal community against one another in a litigious free-for-all. In its place, we would support a system including a well-constructed price cap model that properly addresses the Postal Service's economic situation.

To protect service, the new model must include an opportunity for the Postal Service to go back to the regulator for special relief in exigent circumstances.

The Board is determined to do everything we can to hold future prices within reason, for the benefit of our customers and out of necessity for the long-term health of the institution.

None of us has a crystal ball, however, and experience has reminded us of the power of intervening events to overturn the best of plans and projections.

This necessarily means that the Postal Service must have more control over the benefits dimension of its cost structure. Over the last five years, hourly wage expense has increased by an average 3.2 percent per year.

At the same time, the cost of employee health benefits has increased 11.0 percent. Retiree health benefits cost has grown by 15.6 percent. Workers' compensation expense has increased by 10.9 percent. All of which are out of the control of the Postal Service.

In a period of declining First-Class Mail volume and revenue contribution, the Postal Service cannot hope to keep total costs within inflation in the face of double-digit increases in the cost of benefit programs which it does not manage or control.

All of my adult life, I have been a strong believer in, and an advocate for, collective bargaining. I am opposed to the suggestion that a postal regulator should have any role in setting postal wages or wage standards.

By the same token, I believe that for collective bargaining to be effective, everything should be on the table, including benefit programs.

And speaking of benefits, we are on the record as recommending that the obligation to fund the military service costs of postal employees' Civil Service Retirement System retirement benefits return to the Department of the Treasury. And we have also recommended that the escrow provisions of the Act be eliminated and that the "savings" be used to fund retiree health care benefits, retire debt or fund capital expenditures. Both of these issues could have a profound effect on our ability to manage to the bottom line in the years ahead, and the Postmaster General will address these topics in greater detail in his remarks.

In closing, let me say that the Board of Governors will continue to do everything possible to protect the basic right of affordable, universal mail service for everyone in America. We will assure that all positive actions within the current law will be taken to make the Postal Service more efficient and customer responsive.

Yet we must face the simple fact that our business model — established by the 1970 Postal Reorganization Act — is no longer valid. We can no longer expect that the costs of serving a continually expanding delivery base will be offset by increasing revenue from continued mail volume growth.

This is my last year of service on the Board, so I have some perspective on the process. I intend to continue working with the entire mailing community on these critical issues. And I know the Board of Governors will continue to direct the organization with the full range of tools available to us under current law.

As the Board has demonstrated over the last few challenging years, the current management and governance system works. The fact that we are having this conversation in anything other than a crisis mode confirms it.

But we are reaching the limits of the current opportunities available to us. We cannot keep pulling rabbits out of our financial hat. That is no way to run a business.

Sooner or later, the status quo is going to have drastic consequences for the Postal Service and the entire mailing industry. If prices are forced to rise too rapidly, mail volume will only fall even faster. Service could be affected as well.

We must change the basic assumptions about the business of delivering the mail in America, and we must do it while we have the window of opportunity that our current financial good news affords us.

The time is now to provide us with the new tools to allow us to manage this $68 billion service the right way, like a business, with our eye on the bottom line.

The conversation has already begun. The Commission brought informed proposals to the critical consideration of the future of our nation's mail service. The President has made recommendations based on the Commission’s report. The Board of Governors of the Postal Service intends to remain engaged in that discussion as well.

And we will continue to do everything in our power to assure that the Postal Service of the 21st century will continue providing affordable, universal mail service for all customers and all communities in America.

Thank you, Mr. Chairman and Members of the Special Panel.

# # # #