

GAO

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U.S. POSTAL SERVICE

**Key Elements of
Comprehensive Postal
Reform**

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





Highlights of [GAO-04-397T](#), a testimony before the Special Panel on Postal Reform and Oversight, House Committee on Government Reform

Why GAO Did This Study

Both the Presidential Commission on the U.S. Postal Service and GAO's past work have reported that universal postal service is at risk and that reform is needed to minimize the risk of a significant taxpayer bailout or dramatic postal rate increases.

GAO has testified that Congress should enact comprehensive postal reform legislation that would clarify the Postal Service's (the Service) mission and role; enhance governance, transparency, and accountability; improve regulation of postal rates and oversight; help to ensure the rationalization of the Service's infrastructure and workforce; and make needed human capital reforms.

The administration has also supported postal reform, outlining guiding principles intended to ensure that the Service: implements best practices with a governing body equipped to meet its responsibilities; enhances transparency of timely and accurate data on postal costs and performance; provides greater flexibility for the Service to meet its customer obligations; ensures accountability through appropriate independent oversight; and keeps the Service financially self-sufficient, covering all of its obligations. GAO was asked to discuss comprehensive postal reform in light of these principles.

This testimony is largely based on prior GAO reports and testimonies.

www.gao.gov/cgi-bin/gettrpt?GAO-04-397T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Mark Goldstein at (202) 512-2834 or goldsteinm@gao.gov.

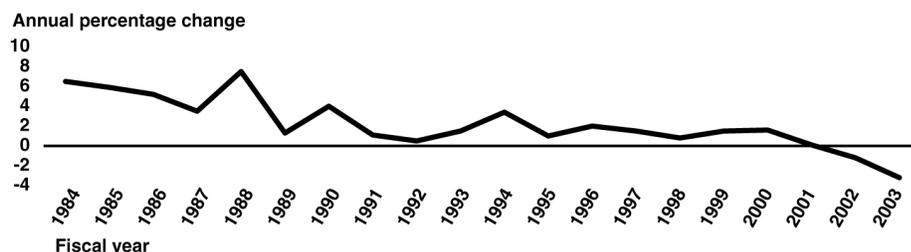
U.S. POSTAL SERVICE

Key Elements of Comprehensive Postal Reform

What GAO Found

GAO believes that comprehensive postal reform is urgently needed. The Service achieved notable success in fiscal year 2003, but this respite is likely to be short-lived. The outlook is for continuing declines in the core business of First-Class Mail, while some key costs are rising and productivity gains are likely to slow.

First-Class Mail Volume Growth, Fiscal Years 1984 through 2003



Source: Postal Service.

Key postal reform issues that need to be addressed are:

The Service's Mission and Role as a Self-Financing Federal Entity

The Service has a broadly defined mission that enables it to engage in unprofitable and costly endeavors. In our view, the time has come for Congress to clarify the Service's core mission and ensure continuity across changes in its management. Key issues include what should be the scope of the postal monopoly, and should the Service retain its regulatory functions.

Governance, Transparency, and Accountability Mechanisms

Better governance, transparency, and accountability mechanisms are needed. Qualification requirements are too general to ensure that board appointees have the experience needed to oversee a large business-like operation. Enhanced transparency and accountability mechanisms are also needed for financial and performance information, such as reporting requirements.

Flexibilities and Independent Oversight

The Service needs additional flexibilities so it can generate needed revenues, contain costs, and provide quality service. Major changes to the rate-setting structure are needed to enhance flexibility, encourage greater cost allocation, provide better cost data, and strengthen independent oversight. Also, current legal and other constraints serve to limit the Service's ability to rationalize its infrastructure and workforce, including closing unnecessary post offices.

Human Capital Reforms, Including Pension, Benefit, and Escrow Issues

Outstanding human capital issues include the Service's responsibility for pension costs related to military service, funding the Service's significant obligations for retiree health benefits, and determining what action to take on the escrow account established as a result of the enactment of P.L. 108-18. Other key areas for reform include workers' compensation and pay comparability.

Chairman McHugh and Members of the Special Panel:

I am pleased to be here today to participate in this hearing on postal reform. In my testimony today, I will focus on (1) the need for postal reform and (2) key areas for comprehensive postal reform. Recently, the U.S. Postal Service (the Service) has gained some financial breathing room primarily because legislation enacted in April 2003 (P.L. 108-18)¹ has reduced the Service's payments for its pension obligations. The Service's net income in fiscal year 2003 was a record \$3.9 billion, of which about \$3 billion was the result of this legislation. In addition, the Service reported that it has made notable progress in its cost-cutting efforts. In fiscal year 2003, the Service downsized its workforce by 27,000 employees, increased its productivity for a record fourth consecutive year, and achieved \$1.1 billion in cost reductions. As a result, the Service reduced its debt by \$3.8 billion in fiscal year 2003 to \$7.3 billion at the end of the fiscal year. The Service also maintained high levels of customer satisfaction and timely delivery of collection-box First-Class Mail, setting new records in each of these areas. The Service is justifiably proud of these achievements.

However, as the Service has recognized, its respite is likely to be short-lived, given increasing competition and the Service's formidable financial, operational, and human capital challenges. As the President's Commission on the United States Postal Service (the presidential commission) noted, the nation's communications, technology, and delivery markets have seen vast changes since the Service was created by the Postal Reorganization Act of 1970.² New types of electronic communications include the use of e-mail, wireless technology, and electronic bill payment services. These technological advances appear to have placed First-Class Mail volume in the early stages of a long-term decline. In addition, the Service faces increased competition from private delivery companies, some of which have established national ground delivery systems and a national network of retail facilities. In this new environment, unless the Service's operating expenses can be reduced correspondingly, with a rightsizing of both its infrastructure and workforce, it is questionable whether affordable

¹The Postal Civil Service Retirement System Funding Reform Act of 2003, Pub. L. No. 108-18, 117 Stat. 624.

²President's Commission on the United States Postal Service, *Embracing the Future: Making the Tough Choices to Preserve Universal Mail Service* (Washington, D.C.: July 31, 2003).

universal mail service can be sustained over the long term with a self-financing public institution.

Recent developments strengthen our view that enactment of postal reform legislation is urgently needed so that the Service can achieve a successful transformation to modernize itself and continue as a viable provider of universal postal service in the 21st century. To summarize:

- *Declining mail volume:* Total mail volume declined in fiscal year 2003 for the third year in a row—a historical first for the Service, which has depended on rising mail volume to help cover rising costs and mitigate rate increases. First-Class Mail volume declined by a record 3.2 percent in fiscal year 2003 and is projected to decline annually for the foreseeable future. This trend is particularly significant because First-Class Mail covers more than two-thirds of the Service's institutional costs.
- *Changes in the mail mix:* The Service's mail mix is changing with declining volume for high-margin products, such as First-Class Mail, and increasing volume of lower-margin products, such as some types of Standard Mail. These changes reduce revenues available (contribution) to cover the Service's institutional costs.
- *Increased competition from private delivery companies:* Private delivery companies dominate the market for parcels greater than 2 pounds and appear to be making inroads into the market for small parcels. Priority Mail volume fell 13.9 percent in fiscal year 2003 and over the last 3 years has declined nearly 30 percent. Once a highly profitable growth product for the Service, Priority Mail volume is declining as the highly competitive parcel market turns to lower-priced ground shipment alternatives. Express Mail volume is declining for the same reason. In addition, United Parcel Service (UPS) and FedEx have established national networks of retail facilities through UPS's acquisition of MailBoxes Etc., now called UPS Stores, and FedEx's recent acquisition of Kinko's.
- *Subpar revenue growth:* The Service's revenues are budgeted for zero growth in fiscal year 2004, which would be the first year since postal reorganization that postal revenues have failed to increase. However, as the Service has recognized, even the zero-growth target will be challenging. In the absence of revenue growth generated by increasing volume, the Service must rely more heavily on rate increases to cover rising costs and help finance capital investment needs.

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- *Declining capital investment:* The Service's capital cash outlays declined from \$3.3 billion in fiscal year 2000 to \$1.3 billion in fiscal year 2003, which was the lowest level since fiscal year 1986, and far below the level of the late 1990s, when the Service spent more than \$3 billion annually. Capital cash outlays are budgeted to increase to \$2.4 billion in fiscal year 2004, but this level may not be sufficient to enable the Service to fully fund its capital investment needs. In the longer term, it is unclear what the Service's needs will be to maintain and modernize its physical infrastructure, as well as how these needs will be funded.
 - *Renewed difficulties in substantially improving postal productivity:* The Service's productivity increased by 1.8 percent in fiscal year 2003 but is estimated to increase by only 0.4 percent in fiscal year 2004. In the absence of mail volume growth, substantial productivity increases will be required to help cover cost increases generated by rising wages and benefit costs and to mitigate rate increases.
 - *Significant financial liabilities and obligations:* Despite the passage of legislation that reduced the Service's pension obligations, the Service has about \$88 billion to \$98 billion in liabilities and obligations that include \$47 billion to \$57 billion in unfunded retiree health benefits. Under the current pay-as-you go system, the Service may have difficulty financing its retiree health benefits obligation in the future if mail volume trends continue to impact revenues while costs in this area continue to rise. The Service has recently proposed two options to Congress so the Service could prefund this obligation to the extent that it is financially able.
 - *Uncertain funding for emergency preparedness:* The Service requested \$350 million for emergency preparedness for fiscal year 2004, which it did not receive, and \$779 million for fiscal year 2005. If the money is not appropriated, funding for this purpose may have to be built into postal rates.
 - *Challenges to achieve sufficient cost cutting:* The Service achieved additional cost cutting to compensate for below-budget revenues in fiscal year 2003. Despite this progress, in the longer term it is unclear whether continued cost-cutting efforts can offset declines in First-Class Mail volume without impacting the quality of service.

In view of the Service's continuing financial, operational, and human capital challenges, as well as trends that increase the urgency of making rapid progress in transforming its organization, we believe that Congress should enact comprehensive postal reform legislation that includes the

Service's overall statutory framework, resolution of issues regarding the Service's pension and retiree health benefits obligations, and whether there is a continued need for an escrow account. We are pleased that the administration has engaged with Congress and other stakeholders on these important issues, and agree with the administration's principles for postal reform.³ We also believe that the findings and recommendations of the presidential commission's report made a valuable contribution to assist Congress, the administration, the Service, and other stakeholders in considering the actions needed to transform the Service to a more high-performing, results-oriented, transparent, and accountable organization. My testimony, based on our prior reports and testimonies⁴ and our continuing work in this area,⁵ will address the need for postal reform and the key areas for comprehensive postal reform, including

- clarifying the Service's mission and role by defining the scope of universal service and the postal monopoly and clarifying the role of the Service in regard to competition;
- enhancing governance, transparency, and accountability by delineating public policy, operational, and regulatory responsibilities, as well as defining appropriate transparency and accountability mechanisms;
- improving flexibilities and oversight by balancing increased postal flexibility with an appropriate level of independent oversight and addressing selected legal and other constraints that limit the Service's

³<http://www.treas.gov/press/releases/js1044.htm>.

⁴U.S. General Accounting Office, *U.S. Postal Service: Bold Action Needed to Continue Progress on Postal Transformation*, [GAO-04-108T](#) (Washington, D.C.: Nov. 5, 2003); *U.S. Postal Service: Key Postal Transformation Issues*, [GAO-03-812T](#) (Washington, D.C.: May 29, 2003); *Major Management Challenges and Program Risks: U.S. Postal Service*, [GAO-03-118](#) (Washington, D.C.: January 2003); *U.S. Postal Service: Moving Forward on Financial and Transformation Challenges*, [GAO-02-694T](#) (Washington, D.C.: May 13, 2002); *U.S. Postal Service: Deteriorating Financial Outlook Increases Need for Transformation*, [GAO-02-355](#) (Washington, D.C.: Feb. 28, 2002); *U.S. Postal Service: Financial Outlook and Transformation Challenge*; [GAO-01-733T](#) (Washington, D.C.: May 15, 2001); and *U.S. Postal Service: Transformation Challenges Present Significant Risks*, [GAO-01-598T](#) (Washington, D.C.: Apr. 4, 2001).

⁵We did not independently verify any Postal Service data, although data from its financial statements were audited by an independent auditor. Some other data, such as data on mail volumes and costs, were produced by data systems that have been reviewed by the Postal Rate Commission, by stakeholders participating in rate cases, and by the 1999 Data Quality Study. See A.T. Kearney, *Data Quality Study* (Alexandria, Virginia: Apr. 16, 1999).

ability to rationalize its infrastructure and workforce; and

- making needed human capital reforms such as determining the Service's responsibility for pension costs related to military service, funding retiree health benefits, and determining what action to take on the escrow account established in recent pension legislation, deciding whether postal workers' compensation benefits should be on par with those in the private sector, and clarifying pay comparability standards.

The Need for Comprehensive Postal Reform Legislation

Our conviction, shared by the presidential commission, the Service, the administration, and others, is that postal reform is needed. The status quo has not produced satisfactory results and the temporary surpluses generated by P.L. 108-18 are unsustainable. Incremental steps toward postal transformation cannot resolve the fundamental and systemic issues associated with the Service's current business model. The Service's long-term financial challenges remain, and, accordingly, the Service's long-term outlook and transformation efforts remain on our High-Risk List.

Fundamental changes will need to be made to the Service's business model, and the legal and regulatory framework that supports it, to help assure the Service's long-term financial viability. Now that the presidential commission has finished its work, the time has come for Congress to act. Structural issues contributing to the need for postal reform include the following:

- *Uncertain financial future:* The Service is intended to be self-supporting through postal revenues. However, as the presidential commission noted, even after recent statutory changes reduced the Service's unfunded liability for Civil Service Retirement System (CSRS) pension benefits, the Service has accumulated over \$85 billion in financial liabilities and obligations over the past three decades. These liabilities and obligations include large unfunded obligations for retiree health benefits, workers' compensation liabilities, remaining pension obligations, and debt. Given the Service's demographics and current health care trends, the costs and obligations related to retiree health benefits are expected to continue rising at a rapid rate. These growing obligations will increase financial pressure on the Service at a time when revenues from First-Class Mail are expected to continue to decline.
- *Difficulty financing capital needs:* In recent years, as the Service's debt level neared its \$15 billion cap, the Service found it problematic to obtain adequate financing for capital needs and thus curtailed capital spending. Recently enacted pension legislation has resulted in an increase in cash flow, and the Service plans to increase capital

spending for fiscal year 2004. However, in the longer term, it may be difficult for the Service to obtain adequate funds to address its capital needs, including modernizing its aging network of postal facilities, without significantly increasing rates or debt. An additional potential source of funding is the disposition of surplus real estate, because the Service is allowed by law to retain all revenues received from the disposition of postal assets. Although the current market value of the Service's portfolio is unknown, its book value is approximately \$15 billion.

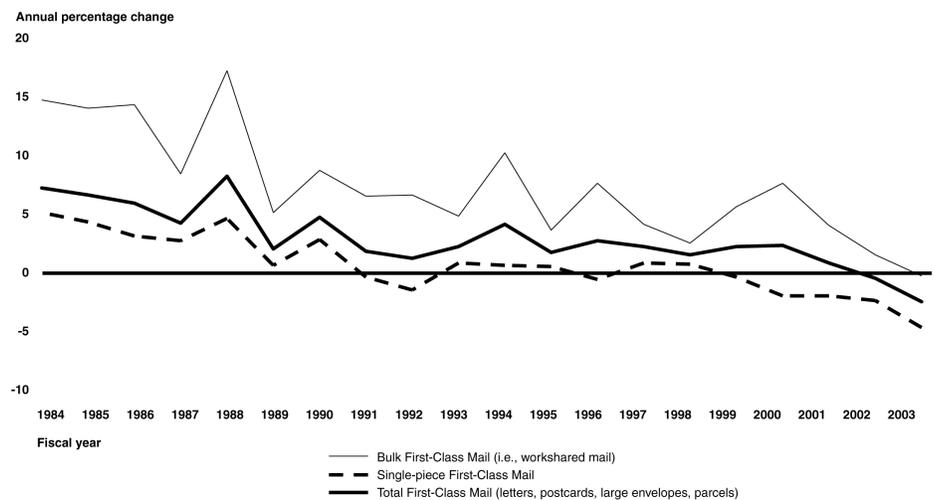
- *Limited incentives for success:* The current legal framework, which was designed to help the Service fulfill universal service mandates, does not provide the same types of incentives that apply to the private sector. Under the statutory break-even mandate and postal monopoly, the Service does not have the profit motive or direct competition (in letter mail) like the private sector does. In addition, the rate-setting structure has allowed the Service to cover rising costs by increasing rates. Moreover, whatever cost reductions the Service achieves in one rate cycle are used to reset the estimated costs that the Service is to recover in the next rate cycle, limiting incentives for cutting costs and improving productivity. In this regard, a limited retained earnings provision could enable the Service and its employees to benefit from whatever cost reductions are achieved.

Despite the above, the Service has achieved success in reducing total work hours and downsizing its workforce by over 74,000 employees over the past 3 fiscal years, which has helped the Service contain its costs. However, cost cutting is likely to achieve diminishing returns under the current structure, which restricts the Service's flexibility and provides limited incentives. Thus, postal reform is needed to enhance incentives and enable the Service to achieve major advances in postal productivity and continued cost reductions. Such advances may be achieved through continuing automation as well as realignment of the Service's processing and retail networks.

As previously noted, the likelihood of declining First-Class Mail volume is another key impetus for postal reform. Its rate of growth has been in long-term decline since the 1980s. First-Class Mail can be divided into two categories that are both declining in volume: (1) single-piece mail, such as letters, which is sent at the rate of 37 cents plus 23 cents for each additional ounce; and (2) bulk mail, which receives discounts for worksharing activities performed by mailers (see fig. 1). The single-piece mail includes remittance mail, which is impacted by diversion to other forms of payment, such as automatic deductions from bank accounts,

automatic charges to credit cards, and other electronic payments. The bulk mail includes mailings of bills and statements, and advertising mail. Single-piece First-Class Mail volume declined by a record 5.4 percent in fiscal year 2003, while bulk First-Class Mail volume declined by 1 percent—the first such decline since worksharing discounts were implemented in fiscal year 1976.

Figure 1: First-Class Mail Volume Growth, Fiscal Years 1984 through 2003



Source: Postal Service.

First-Class Mail generates more than half of the Service’s revenue and covers more than two-thirds of its institutional costs. Standard Mail volume is growing, but it makes a smaller per-piece contribution than First-Class Mail and its volume is considered more price sensitive to rate increases. Parcel Post volume is also growing, but not enough to offset declines in Priority Mail. Periodicals mail is priced at cost, and other sources of Service revenue make a relatively small contribution to its institutional costs. Thus, the loss of contribution from declining First-Class Mail volume is difficult to recover from other classes of mail.

Looking ahead, a report prepared for the presidential commission found that growth in electronic payments is likely to be an important factor in its forecast of gradual declines in First-Class Mail volume.⁶ The rapid

⁶Institute for the Future, *Two Scenarios of Future Mail Volumes: 2003-2017*, prepared for the President’s Commission on the United States Postal Service (Palo Alto, California: May 2003).

diffusion of computer, Internet, and broadband technologies has led to high adoption rates among those with high levels of income and education—the same groups that send and receive a disproportionate share of First-Class Mail. These trends point to the strong potential for further diversion. Raising postal rates to offset this trend may provide an immediate boost to the Service’s revenues, but over the longer term will likely accelerate the transition of mailed communications and payments to electronic alternatives, including the Internet.

If the Service’s core business of First-Class Mail continues to decline, it will face the formidable challenge of maintaining affordable universal postal service by growing revenues, significantly cutting costs, or reducing service standards. In order to achieve net cost savings, the Service’s cost-cutting efforts must currently offset billions of dollars in annual cost increases for general wage increases, cost-of-living adjustments, and rising benefits costs, particularly in health insurance premiums, as well as infrastructure and workforce costs associated with having to deliver mail to over 1.5 million new addresses every year. Thus, maintaining the quality and affordability of postal services would likely require dramatic improvement in the Service’s efficiency. In order to do so, the Service will need to become a much leaner and more flexible organization and rightsize its processing and retail networks and its workforce.

More significant and frequent rate hikes are also likely to be needed to cover the costs of benefits that are being earned by current employees and financed under existing cash-based accounting and rate-setting methods. One of the key reform challenges facing Congress and the Service is the funding of the Service’s financial liabilities and obligations, including unfunded retiree health benefits, workers’ compensation benefits, and Civil Service Retirement System (CSRS) pension obligations. Although recent legislation addressed how the Service will cover its CSRS pension obligations over a 40-year period, the Service continues to make minimum payments for the other obligations, which are currently financed on a pay-as-you go basis. Based on known demographic trends, the Service’s payments on its retirees’ health insurance premiums are expected to continue rising until about 2040.

Congress is currently reviewing the Service’s retirement-related obligations. We believe that it would be prudent for the Service to address the unfunded obligations today, in a manner that is fair and balanced for both current and future ratepayers. In response to the requirement in the Postal Civil Service Retirement System Funding Reform Act of 2003 (P.L.108-18) that the Service report on how it proposes to use the pension

“savings” resulting from the act, the Service proposed to prefund at least a portion of its retiree health benefits obligation. We found that although this proposal would result in marginally higher postal rate increases, at least in the short term, it strikes a reasonable and equitable balance between current and future ratepayers, and addressed one of the Service’s substantial future obligations. On a related matter, we recommended that Congress repeal the escrow requirement established by P.L. 108-18 after receiving an acceptable plan from the Service describing how it intends to rationalize its infrastructure and workforce and is confident that the Service is making satisfactory progress on transforming itself into a more efficient organization and implementing its other transformation goals.⁷ This recommendation and related considerations, including responsibility for military service pension costs, are discussed further in this statement. Taken together, consideration of the escrow requirement, postal reform, and the Service’s retiree health benefits obligation represents a rare opportunity to address the Service’s long-term financial viability.

Major Elements Needed for Comprehensive Postal Reform

We and the presidential commission have reported that universal postal service is at risk and that reform is needed to minimize the risk of a significant taxpayer bailout or dramatic and more frequent postal rate increases. We have testified that Congress should enact comprehensive postal reform legislation that would clarify the Service’s mission and role; enhance its governance, transparency, and accountability; balance enhanced flexibility and oversight to improve regulation of postal rates; help to ensure the rationalization of the Service’s infrastructure and workforce; and make needed human capital reforms. The administration has also supported postal reform and outlined guiding principles to ensure that the Service: implements best practices with a governing body equipped to meet the responsibilities and objectives of an enterprise of its size and scope; enhances transparency of timely and accurate data on postal costs and performance; provides greater flexibility for the Service to meet its obligations to customers in a dynamic marketplace; ensures additional accountability through appropriate independent oversight; and keeps the Service financially self-sufficient, covering all of its obligations. In the following sections of this testimony, I discuss comprehensive postal reform in light of these principles.

⁷U.S. General Accounting Office, *Postal Pension Funding Reform: Issues Related to the Postal Service’s Proposed Use of Pension Savings*, [GAO-04-238](#) (Washington, D.C.: Nov. 26, 2003).

Postal Service Mission and Role Need Clarification

It is important for Congress to consider how best to clarify the mission and role of the Postal Service as part of a fundamental reexamination of the role of the federal government in the 21st century. As the presidential commission recognized, the nation's postal laws that established the Service in the early 1970s did not envision the challenge of setting appropriate boundaries on the Service's commercial activities and maintaining fair competition between the Service and the private sector. These issues need to be addressed because the Service has repeatedly strayed from its core mission. We have reported on the Service's money-losing initiatives in electronic commerce and remittance processing, among other things.⁸ The Service's ill-fated ventures were also questioned by some postal stakeholders as unfair competition, since they were cross-subsidized by a tax-exempt entity that is also exempt from many laws and regulations governing the private sector. Further, such ventures have raised the fundamental issue of why the federal government is becoming involved in areas that are well served by the private sector. Although the current Postmaster General has appropriately focused on the Service's core business of delivering the mail and sharply curtailed its nonpostal initiatives, the presidential commission recommended codifying this policy. In our view, the time has come for Congress to clarify the Service's core mission and ensure continuity across changes in postal management. Key questions in this area include the following:

- How should universal postal service be defined in the 21st century?
- Should the Service be allowed to compete in areas where there are private-sector providers? If so, in what areas and on what terms? What laws should be applied equally to the Service and to its competitors?
- Should the Service's competitive products and services be subject to antitrust and general competition-related laws? Should they be subject to consumer protection laws?
- Should the Service retain its regulatory responsibilities and law enforcement functions?

⁸U.S. General Accounting Office, *U.S. Postal Service: Update on E-Commerce Activities and Privacy Protections*, [GAO-02-79](#) (Washington, D.C.: Dec. 21, 2001); *U.S. Postal Service: Postal Activities and Laws Related to Electronic Commerce*, [GAO/GGD-00-188](#) (Washington, D.C.: Sept. 7, 2000); and *U.S. Postal Service: Development and Inventory of New Products*, [GAO/GGD-99-15](#) (Washington, D.C.: Nov. 24, 1998).

On a related issue, the Service's current statutory monopoly on the delivery of letter mail and its monopoly over access to mailboxes have historically been justified as necessary for the preservation of universal service.⁹ However, questions have been raised regarding whether these restrictions continue to be needed; and if so, to what extent and whether the Service should be able to define their scope. Narrowing or eliminating the monopoly could increase consumer choice and provide incentives for the Service to become more effective and efficient. For example, in the competitive parcel market, FedEx has expanded its role in delivering residential parcels and UPS has shortened its guaranteed transit time on ground shipments traveling to some of the country's biggest metropolitan areas.

Another issue is whether the Service, as a commercial competitor in the overnight and parcel delivery markets, should have the authority to regulate the scope of competition in these areas.¹⁰ The presidential commission has recommended separating these functions so that the Postal Service cannot define and regulate the scope of its own monopoly. As the presidential commission noted, it is a fundamental premise of American justice that parties that administer laws should not have a financial interest in the outcome. Questions relating to the postal monopoly include the following:

- Is a government monopoly needed to enable affordable universal postal service, especially if such service is provided at uniform rates? If so, what scope of monopoly is needed?
- Should the Service continue to have the power to define and regulate its own statutory monopoly, including use of the suspension process?
- Should a regulatory body have authority to redefine and narrow the postal monopoly and the mailbox monopoly? If so, should a clear statement of congressional intent be provided to guide regulatory decisions, or should the regulator have unfettered discretion to

⁹U.S. General Accounting Office, *U.S. Postal Service: Information about Restrictions on Mailbox Access*, GAO/GGD-97-85 (Washington, D.C.: May 30, 1997).

¹⁰The Service has used its regulatory power to further define the scope of the statutory monopoly by suspending the monopoly for urgent letters and outbound international mail. The Service has also defined the scope of its monopoly by issuing regulations that define a "letter" for the purposes of enforcing the statute (39 C.F.R. § 310.1(a)) as well as regulations specifying access to mailboxes (Domestic Mail Manual, D041 and P011.2.2).

consider options to expand or contract the Service's monopoly? What principles should guide the process, and what key players should be involved?

- Similarly, should the regulator be able to consider opening up access to the mailbox? If so, under what circumstances? Would it be cost effective for private delivery companies to deliver items to mailboxes if individuals could veto access and redefine mailbox access as the delivery companies move from one home to another?
- Should any regulatory decisions be governed by process requirements to enable stakeholder input? Should such processes facilitate congressional review of any changes, as is the case for some other types of communications regulated by the federal government?

The Need for Enhanced Governance, Transparency, and Accountability Mechanisms

In our view, the Service must have greater flexibility to operate in a businesslike fashion, but with this latitude comes the need for enhanced governance, transparency, and accountability mechanisms. Managerial accountability must come from the top, with the Service governed by a strong, well-qualified corporate-style board that holds its officers responsible and accountable for achieving real results both currently and over time. In addition, despite recent improvements, we continue to be concerned that additional transparency mechanisms be implemented to enhance the Service's accountability for financial and performance results.

Governance Issues

If the Service is to successfully operate in a more competitive environment, the role and structure of a private-sector board of directors may be an appropriate guide for governance. Having a well qualified, independent, adequately resourced, and accountable board is critical for a major federal institution with annual revenues approaching \$70 billion and almost 830,000 employees at the end of fiscal year 2003. We agree with the presidential commission that the Service's legacy governance structure is increasingly at odds with its mission in the modern environment and that the Service's governing structure needs to consist of members with the requisite knowledge and experience. In this regard, one issue is what statutory qualification requirements are appropriate for the board to ensure that it has the kind of expertise necessary to oversee a major government business.

Another major issue is whether the Service should be held more directly accountable for its performance, and if so, to what extent, to whom, and with what mechanisms. Specifically, how should the Service's governing

board, along with top management, be held accountable? The presidential commission recommended that the Postal Rate Commission (PRC) be replaced with a newly created regulatory board endowed with broad public policy responsibilities as well as broad mandates and authority for accountability and oversight. These recommendations raise fundamental questions, including the following:

- Who should make certain public policy decisions regarding the Postal Service—the Service, an independent regulator, or Congress?
- What accountability should apply to a monopoly provider of vital postal services that also is a major competitor in the communications and delivery marketplace?
- How should the Service be held accountable if it remains an independent establishment of the executive branch?
- To what extent can the Service be accountable to Congress and the executive branch without being subject to undue political control?
- To what extent should a regulatory body exercise accountability? For what purpose? With what authority? How should it be structured to preserve its independence from political manipulation and minimize the risk of regulatory capture?
- What statutory guidance and constraints should apply to regulatory actions, including due process and recourse to judicial and/or congressional review?

Enhancing Transparency and Accountability of Financial and Performance Information

A key element of postal reform will be the statutory reporting requirements needed to ensure transparency and accountability of financial and performance information. The Service remains a public institution with a monopoly on providing vital postal services to the nation. Hence, appropriate transparency is needed so that stakeholders are well apprised of the Service's financial situation and performance and understand how future results may be affected by impending events, so that changes do not come as a surprise to those responsible for or impacted by its performance.

The Service has made recent progress in this area, but it recognizes that further progress should be made. Enhanced transparency will be essential for stakeholders to better understand the Service's financial situation and performance results, conduct independent oversight, and hold

management accountable.¹¹ In addition, enhanced reporting will be even more critical if the Service obtains greater flexibility to set postal rates in a streamlined manner that relies on rapid verification of compliance. A key issue is whether statutory change is needed to enhance the level of transparency that the Service must provide. We were pleased the Service has recently taken steps to enhance its financial reporting. The Chairman of the Service's Board of Governors also recently indicated that the Service would make further enhancements along the lines of some SEC reporting requirements. In our view, it will be important for Congress to obtain clarification from the Service on how and when it intends to develop financial statements and disclosures comparable to those provided by publicly traded companies. If Congress determines that the Service's proposed approach is not acceptable or timely, or if the Service does not fulfill the commitment it makes in this regard, Congress could consider mandating SEC-type reporting requirements for the Service, or giving a regulatory body authority in this area.

In addition, there are areas where stakeholders still have little information, such as the Service's financial needs for maintaining and modernizing its infrastructure, and the true market value of the Service's vast real estate holdings. Further, we continue to be concerned that the Service does not communicate its delivery performance for all of its major mail categories, particularly those covered by its monopoly. The Service's customers have a right to know what they are getting for their money, particularly captive customers with few or no alternatives to using the mail. Information about service quality would become even more important if the Service obtains more flexibility and incentives to cut its costs. Accordingly, the presidential commission recommended that a regulatory body be required to prepare a comprehensive annual report assessing the Service's performance in meeting established service standards. If such a report is to be meaningful, the regulator may also need authority to require the Service to collect service performance data.

¹¹U.S. General Accounting Office, *U.S. Postal Service Actions to Improve Its Financial Reporting*, GAO-03-26R (Washington, D.C.: Nov. 13, 2002); and *U.S. Postal Service: Enhancements Needed in Performance Planning and Reporting*, GAO-00-207 (Washington, D.C.: Sept. 19, 2000).

Key questions related to transparency and accountability include the following:

- What transparency of the Service’s financial and performance results is appropriate for oversight and accountability? What mechanisms should be established to facilitate and ensure adequate transparency?
- What transparency and accountability mechanisms are needed to prevent unfair competition and inappropriate cross-subsidization?
- Should the Service comply, either on a voluntary basis or through a statutory requirement, with major Securities and Exchange Commission (SEC) reporting requirements?

Flexibilities and Independent Oversight

Giving the Service greater flexibility to operate in a businesslike manner also would require enhanced oversight by an independent regulatory body endowed with sufficient authority and resources, as well as continued congressional oversight. Current law mandates independent review of postal rates and has the laudable goals of protecting postal customers against undue discrimination, restricting cross-subsidies, and ensuring due process. However, the current rate-setting structure is adversarial, lengthy and expensive. It also serves to significantly limit the Service’s rate-setting flexibility while providing poor incentives for appropriate cost allocation. In addition, the Postal Rate Commission (PRC) has limited authority, particularly in the areas of cost allocation and ensuring the quality of the supporting data. Improvements in the rate-setting area will be a fundamental component of postal reform legislation. Furthermore, the Service faces legal and other constraints that limit its flexibility to rationalize its infrastructure and workforce. Legislative reforms are needed in this area as well.

More Flexibility and Enhanced Oversight Needed in Rate-Setting Area

As long as the Service remains a federal entity protected by the postal monopoly, its ability to compete with the private sector should be balanced with appropriate oversight and adequate legal standards to ensure fair competition between the Service and private competitors. Clear lines of authority in this area must be established if the rate-setting process is to be streamlined and sped up. A key issue for Congress to consider is the appropriate balance between flexibility and accountability. Another issue is what due process rules should be established in order to enable stakeholders to provide meaningful input and participate in rate-setting matters, including the right to appeal regulatory decisions. Key shortcomings of the current rate-setting structure include the following:

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- *Adversarial, burdensome, and lengthy rate-setting proceedings.* Statutory requirements for rate and classification cases impose a litigious, costly, and lengthy rate-setting process that can delay needed new revenues by more than a year. Because the law enables any interested party to participate, most changes require a major proceeding that places the Service in an adversarial relationship with its major customers and at a distinct competitive disadvantage. Rate cases tend to pit the Service and postal stakeholders against each other, since the zero-sum nature of the break-even requirement provides powerful incentives for parties to attempt to shift postal costs in ways that serve their self-interests. The Service and other stakeholders report spending millions of dollars in each rate case on attorneys, economists, statisticians, and other postal experts who pore over many thousands of pages of testimony, interrogatories, and rebuttals. The high cost of participation, coupled with the increasing complexity of rate-setting data and methods, makes it difficult for smaller stakeholders to effectively participate. Statutory rules against ex parte communications help to preserve due process and fairness, but also make it difficult for experts to constructively discuss technical issues and resolve problems as they arise.
 - *Unresolved, recurring disputes.* The current rate-setting structure, which seeks to assure all parties due process, enables them to repeatedly raise issues that have previously been considered. The Service has a unique opportunity to repeatedly raise issues by building them into its initial rate proposals. For many years, cost allocation issues have been debated and are frequently a key reason why rate cases are so lengthy and litigious, since their disposition can directly affect rates. Although interested parties should have an opportunity to participate in rate cases, the need to address complex cost allocations in every rate proceeding is inconsistent with having a streamlined rate-setting process that swiftly resolves complaints about rates.
 - *Poor incentives for data quality.* Current law gives the Service opportunities to seek advantage in litigious rate cases through its control over what data are collected and how those data are analyzed and reported. PRC cannot compel the Service to collect data, update data, or subpoena information. The 1999 Data Quality Study, which you requested, Mr. Chairman, found that key postal cost data had not been updated for many years and were used regardless of their obsolescence.¹² Although the Service has worked to address these and

¹²A.T. Kearney, *Data Quality Study* (Alexandria, Virginia: Apr. 16, 1999).

other deficiencies identified by the study, it is fair to question why these problems could linger for so long.

- *Disincentives for maximizing cost allocation.* Under current law, all classes of mail and types of service must cover their attributable costs, while institutional costs are allocated based on judgment informed by broad statutory criteria.¹³ In effect, the Service loses pricing flexibility as costs are allocated to specific postal products and services, creating a structural disincentive to allocate costs. The presidential commission's conclusion that more postal costs can and should be allocated raises the issue of whether more regulatory authority is needed to ensure that all costs that can be rationally attributed are properly allocated.
- *Need for Periodic Reporting.* As the presidential commission noted, independent regulatory oversight should ensure that the outcome cannot be unduly influenced through the selective provision of information to the regulator. To this end, a key issue is whether the law should mandate the Service to submit periodic reports in accordance with form, content, and timing requirements determined by a regulatory body. This could involve changing the statute to clarify that the regulator could compel the collection and provision of necessary data, including rate-setting and performance information, that would be analyzed according to cost allocation methods determined by the regulator.

Worksharing discounts

A particularly controversial area includes consideration of worksharing discounts, which are applicable to about three-quarters of the Service's mail volume. Worksharing discounts did not exist when the Postal Reorganization Act of 1970 was enacted. Thus, there is little statutory guidance in this area except for the mandate for the PRC to consider—along with other factors—the degree of preparation of mail for delivery into the postal system performed by the mailer and its effect upon reducing costs to the Service.¹⁴ Over time, the PRC developed a guideline for recommending worksharing discounts so that the estimated reduction

¹³The Service proposes domestic postage rates and fees, as required in law, so that each class of mail or type of service must cover the direct and indirect postal costs that are attributable to that class or type of service plus a portion of its institutional costs. This requirement has long been interpreted to apply to subclasses of mail.

¹⁴PRC is required to consider nine factors in making recommended decisions on postal rates, including such factors as fairness and equity and coverage of attributable costs. See 39 U.S.C. § 3622(b).

in Service revenues would be no more than equal to the estimated reduction in related Service costs. Because worksharing discounts have become an integral part of the rate-setting structure, a key issue is whether statutory guidance would be appropriate in this area, and if so, whether hard-and-fast rules versus a set of key principles or criteria for worksharing discounts should be established in law. Other issues and questions that have been raised in the rate-setting area include the following:

- Should the break-even mandate continue to govern the postal rate-setting process, or should the Service be allowed to retain a certain amount of earnings?
- Is after-the-fact rate review incompatible with the need to ensure fair competition by an organization that can leverage the revenues and infrastructure obtained through its monopoly on delivering letter mail? If not, should measures be taken to limit the potential for unfair competition, such as providing limitations on the introduction of subsidized new products and services? Should a regulatory body be authorized to order the discontinuance of postal products and services that consistently fail to cover their costs?
- Could a complaint process, as a key mechanism to seek redress for rates established with no prior review, create an incentive for numerous complaints that could become a de facto review of virtually all rates? Even if a regulatory body could order changes in rates after the fact, would it be reluctant to do so, given the potential financial impact and disruption for the Service and the mailing industry?
- How much time is needed for meaningful after-the-fact review of changes in postage rates and review of complaints? What due process rules should be established for stakeholder participation in rate complaints and other rate-setting matters?
- What process should govern regulatory decisions regarding the measurement, allocation, and reporting of postal costs and revenues? Should the regulatory body also be given the authority to compel the Service to collect data, as some have suggested?

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- If mailer-specific discounts are authorized, should data be required on the mailer-specific cost savings that the Service expects to achieve? If so, how should the regulatory body balance its needs for such information with limitations relating to the practicality and burden of producing it?
 - What statutory criteria should govern the adoption and review of negotiated service agreements (NSA)? Could NSAs create competitive harm, and, if so, what measures should be taken to mitigate this risk (e.g., prior review and other limitations)?
 - Would a transition period be needed to successfully implement a different rate-setting system and address major unresolved cost allocation issues, as well as for the Service to improve its cost allocation methods and underlying information systems that provide costing data?

Price-cap regulation

As the above discussion demonstrates, the need for changing the postal rate-setting structure is clear. However, many questions remain about what changes should be made and the potential problems associated with those changes. Specifically, the option of adopting a price-cap model for regulating postal rates has emerged as a main alternative to a cost-of-service regulatory model but raises many issues that deserve thoughtful consideration.¹⁵ By its very nature, any fundamental change to the rate-setting system would necessarily entail substantial uncertainty, risks, and the possibility for further change to deal with unanticipated consequences. In this regard, the benefits and risks of adopting a price-cap system need to be weighed against the benefits and risks of the status quo. If the Service is to be limited to its core mission, the flexibility provided by a price-cap system could become a key tool to successfully managing the transition to a leaner, more efficient postal system. A price-cap system also could enable the Service to implement a strategy of smaller, more frequent changes in postal rates, as opposed to a strategy of more infrequent, yet significant increases. We recognize that these proposals have been reviewed in numerous hearings, surfacing many issues and creating a valuable record to build on. Key questions to consider include the following:

¹⁵ A price-cap system could limit rate increases for certain postal products and services according to a specified index, such as the Consumer Price Index.

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- Would a price-cap system provide the intended incentives for the Service to maximize its financial performance, since it is a public institution that is not accountable to shareholders who hold stock and demand management accountability?
 - Would a price cap provide incentives for the Service to reduce the quality of service for captive customers? If so, what transparency and accountability mechanisms would be needed to ensure the quality of universal postal service?
 - Could the Service use its flexibility to raise rates within the price cap to unfairly shift the burden of institutional costs away from competitive products and services and onto its most captive customers?
 - Should the law require that rates for each class of mail or type of service cover the direct and indirect postal costs attributable to them? If so, at what level (e.g., mail class, subclass, rate category, etc.)?
 - Could the Service generate sufficient revenues if its rates were constrained by a price cap? If not, under what circumstances, if any, should the Service be authorized to raise rates in excess of the cap? How can ratepayers be assured that it would not be too easy for the Service to obtain such increases, which would vitiate the intent of the price cap? What process should apply to such “exigent” rate increases?
 - Would a price cap restrain the growth of wages and benefits for postal employees? If so, to what extent and would such a result be desirable?
 - How would a price-cap system affect historic preferences that have been provided to certain mailers, such as mailers of nonprofit mail, periodicals, and library mail?
 - How could the Service redesign the rate and classification system, as it did through the 1995 reclassification case, if it were subject to a price cap? How could more limited classification changes be adopted?
 - Would adopting a price-cap system be too risky, given problems that have surfaced in some price-cap models adopted by other regulated industries? How could flexibility be built into the system to minimize risk and handle “the law of unintended consequences?”

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- Should Congress specify provisions of a price-cap system? If so, what features should be codified in statute and which should be left to the regulatory process?
 - What issues should be considered in adapting price-cap regulation from other industries and foreign postal systems to the unique context of regulating postal rates in the United States?
 - What transition features should be required, such as a “baseline” rate case, in order to successfully implement a price-cap system?
 - What other regulatory models should be considered in the rate-setting area?

Constraints to Flexibility of the Service’s Operations and Infrastructure

The Service’s uncertain future regarding its mail volume and revenue growth makes it imperative for the Service to become a more cost-effective and efficient organization. To facilitate this, the Service’s governing body and management must have the authority and flexibility to reduce costs and modify its business operations. There are a number of inefficiencies in the Service’s current infrastructure, which has evolved piecemeal over decades and may not adequately reflect current and future needs. This infrastructure includes approximately 38,000 post offices, stations, and branches; 500 mail processing and distribution facilities; and other facilities. On the retail side, many post office transactions, like selling stamps, can be conducted more efficiently through other retail alternatives. On the processing and distribution side, efficiency varies across facilities, in part because the Service does not have standardized operations.

Although the Service recognizes the need to rationalize its infrastructure, several current legal constraints hinder its flexibility. A key question for Congress to consider is whether current legal restrictions on closing post offices should be retained, modified, or repealed. Under current law, the Service is not allowed to close post offices for economic reasons alone.¹⁶ In making a determination on whether to close or consolidate a post office, the Service is required to consider the effect on the community, postal employees at that office, and the resulting economic savings, among other things.¹⁷ All post office closings are also subject to a statutory

¹⁶39 U.S.C. § 101(b).

¹⁷39 U.S.C. § 404(b)(2).

process that governs notification and appeals, which can delay closings for an extended period.¹⁸ In addition, annual appropriations bills have long specified that no appropriated funds shall be used to consolidate or close small rural and other small post offices.

Regulations further specify processes that the Service must follow for closing, consolidating, and relocating post offices. The Service can also suspend post office operations in an emergency without following the normal procedures but must notify affected customers individually and establish alternative services as quickly as possible. While there are no statutory regulations against closing mail processing and distribution facilities, these facilities are often co-located with post offices that are subject to statutory constraints. In addition, the Service often encounters political resistance when it determines to close, consolidate, or relocate postal facilities. Government officials are understandably concerned about decisions that affect customers, postal employees, as well as communities and constituents. In any event, it will be important for the Service to communicate with and consider the concerns of those affected by facility closings or other changes.

Greater flexibility for the Service to reshape its infrastructure must be accompanied by enhanced transparency and accountability mechanisms. Because rationalizing its infrastructure and workforce is crucial to the Service's future financial viability and has potentially broad impacts, we recommended that the Service prepare a publicly available plan that lays out its vision and strategies in this area.¹⁹ This plan should include the key principles or criteria that will guide the Service's decisions, the processes that will be used to make its decisions, and the players that will be involved. We have also recommended that repeal of the escrow requirement be contingent on Congress's receipt of a satisfactory plan from the Service describing how it intends to rationalize its infrastructure and workforce.²⁰ Both the House and Senate oversight committees have sent letters to the Postmaster General requesting the Service to provide Congress with a plan for rationalizing the Service's infrastructure and workforce. Service officials told us that they are in the process of

¹⁸39 U.S.C. § 404(b)(3)(4)(5).

¹⁹[GAO-04-108T](#).

²⁰[GAO-04-238](#).

developing the requested plan and intend to provide it to Congress by February 2.

Human Capital Issues

The Postal Service's human capital is critical to providing vital postal services to the American people and achieving a successful postal transformation. The Service employed almost 830,000 people at the end of fiscal year 2003, whose pay and benefits accounted for more than three-quarters of the Service's expenses. The Service reported that its operating expenses fell by about \$1.3 billion in fiscal year 2003 due primarily to pension reform and work hour reductions. Another area where the Service continues to make encouraging progress is in the declining number of total grievances, which as of the end of fiscal year 2003 had fallen to 93,483, less than half the number at the end of fiscal year 1998. Further progress on controlling human capital costs will be critical to sustain both affordable and universal postal service. The Service's hourly compensation costs, including wages and benefits, are rising faster than inflation, and key issues remain unresolved regarding the Service's pension and retiree health benefits obligations. We believe that the time is right to consider what statutory structure would be appropriate to address these issues, facilitate best practices, and improve labor-management relations and overall working conditions. In this section of my statement, I will focus on (1) funding of pension and retiree health benefits obligations; (2) workers' compensation provisions; and (3) criteria for pay comparability.

Postal Pension and Retiree Health Benefits Issues

The Service's substantial obligations for its retirement-related benefits need to be addressed, especially in connection with its retiree health benefits. A key issue is how to assign responsibility and structure a mechanism for covering the costs of providing retirement-related benefits. Another issue is how changes in funding these obligations could affect postal ratepayers, taxpayers, and the federal budget.

The Postal Civil Service Retirement System Funding Reform Act of 2003 (P.L. 108-18), enacted in April 2003, changed the method by which the Service funds the Civil Service Retirement System (CSRS) pension benefits of its current and former employees to prevent a projected overfunding from materializing. At the same time, the act shifted responsibility for funding pension benefits attributable to military service from taxpayers to postal ratepayers. The act required that, beginning in fiscal year 2006, the difference between the Service's contributions under the new and old funding methods—the "savings"—be held in an escrow account until the law is changed. To facilitate consideration of which agency—the Postal Service or the Treasury Department—should fund

military service pension costs, the act required the Service, the Office of Personnel Management (OPM), and the Treasury Department to each submit proposals to the President, Congress, and the GAO by September 30, 2003. The act also required the Service to submit a proposal to the same recipients on how it planned to use the future “savings.” We, in turn, provided our analysis of these proposals on November 26, 2003.²¹

Regarding the military service issue, the Service believes that the Treasury should bear responsibility for pension costs related to military service, while Treasury and OPM believe that this responsibility should remain with the Service. We do not take a position on whether the Service or the Treasury should bear responsibility for the military service costs, because we believe that this is a policy decision that should be made by Congress. Instead, we have identified and assessed the agencies’ respective positions and provided additional information to assist Congress in making its decision. In this regard, two key issues were raised by the agencies, with differing views provided—(1) the relationship of military service to employing agencies’ operations and (2) consistency among agencies, especially self-supporting ones. Regarding the first issue, the Service believes that there is no relationship between military service and postal operations and therefore the Service should not bear the pension costs related to military service. Treasury’s view is that the employing agencies should bear this cost, because receiving credit for past military service is a civilian retirement benefit. Absent a conscious, voluntary, and contractual decision to the contrary, typical cost attribution methods would allocate service to the agency that benefited from the military service (Department of Defense). Under such a method, the taxpayers would bear the cost of pensions related to military service.

Regarding consistency, we reported that the Service is required to fund the dynamic normal cost of CSRS benefits, whereas some self-supporting agencies pay only a portion of this cost. Thus, we stated in our Matters for Congressional Consideration that Congress should consider treating all self-supporting entities consistently by requiring dynamic funding of the full cost of pension benefit costs not paid by employee contributions and deposits exclusive of military service costs. We also recommended that Congress should consider requiring consistency across self-supporting

²¹U.S. General Accounting Office, *Postal Pension Funding Reform: Review of Military Service Funding Proposals*, [GAO-04-281](#) (Washington, D.C.: Nov. 26, 2003); and *Postal Pension Funding Reform: Issues Related to the Postal Service’s Proposed Use of Pension Savings*, [GAO-04-238](#) (Washington, D.C.: Nov. 26, 2003).

agencies in assigning responsibility for pension costs related to military service.

Should Congress decide that the Service should retain responsibility for funding military service pension benefits, the appropriate method for allocating the cost of these benefits would need to be decided. In this regard, we recommended in our report that an additional option should be explored for allocating these costs. Specifically, one that makes the Service responsible only for military service that became creditable after postal reorganization took effect on July 1, 1971.²²

The second issue that Congress must consider is the Postal Service's report on use of the pension "savings." The Service submitted two proposals, both of which would affect postal rates to varying degrees. The first proposal recommends that the Service be relieved of the burden of funding pension benefits attributable to military service, and that the Service, in turn, would begin to prefund its retiree health benefits obligation for current and former employees, which has been estimated in fiscal year 2003 at between \$47 billion and \$57 billion. The second proposal is based on the premise that the Service will remain responsible for funding military service benefits as currently required by P.L. 108-18. Under this proposal, the Service said that it would fund its retiree health benefits obligation only for employees hired after fiscal year 2002 and use the remaining "savings" to repay debt and to fund productivity and cost-saving capital investments. In our report, we noted that if either of these proposals were accepted, Congress would need to address implementation issues related to prefunding the retiree health benefits obligation, including who determines the amount of the obligation, what demographic and economic assumptions should be reflected in the obligation amount, and what funding and investment approach should be used.

We assessed these proposals according to their fairness and affordability and how they addressed the Service's transformation efforts, including its cost saving and productivity improvement initiatives. We found that the first proposal strikes a more equitable balance of allocating costs between current and future ratepayers because benefits being earned by today's employees would be built into the current postal rate base. Under the second proposal, a substantial portion of the retiree health benefits

²²Military service that became creditable after postal reorganization would be for employees who did not have at least 5 years of civilian service prior to July 1, 1971.

obligation would remain unfunded, thereby placing the burden of the retiree health benefits being earned today on future ratepayers. Both of the proposals attempted to balance short-term rate mitigation with some level of prefunding of the Service's retirement health benefits obligation. In its first proposal, the Service estimated that an additional rate increase of 2 percent over the rate of inflation would be required in fiscal year 2006. The Service's second proposal would require only an additional increase of 0.3 percent over the rate of inflation since it would be funding a smaller portion of the retiree health benefits obligation. To mitigate the impact of any marginally higher rates needed to prefund retiree health benefits, we believe that the Service must transform itself into a more efficient and effective organization through continued modernization efforts.

Another matter we considered in evaluating the Service's proposals was the impact of the escrow requirement embodied in P.L. 108-18, which we determined could lead to unnecessary rate increases. However, we reported that Congress would need to have sufficient information to determine that the Service is making progress in achieving its transformation goals, including its initiatives to rationalize its infrastructure and workforce. Therefore, we recommended that Congress should repeal the escrow requirement upon receipt from the Service of an acceptable plan for rationalizing its infrastructure and workforce. Both the House and Senate oversight committees subsequently requested that the Service provide a plan on how it intends to rationalize its infrastructure and workforce, and the Service agreed to provide such a plan.

Workers' Compensation Issues

Another benefit area where postal costs have been difficult to control involves the Service's workers' compensation benefits under the Federal Employees' Compensation Act (FECA). The Service reported nearly \$1.5 billion in workers' compensation expense in fiscal year 2003, only \$50 million less than the record set in the previous fiscal year, while its unfunded liability for workers' compensation rose \$526 million to a record \$7.2 billion at the end of the fiscal year. We have reported on FECA issues, including how these benefits compare with those of other federal and state workers' compensation laws and possible changes to FECA benefits for beneficiaries at or beyond retirement age.²³ We reported that to help address FECA-related cost issues, Congress could consider converting

²³U.S. General Accounting Office, *Recent GAO Reports on the Federal Employees' Compensation Act*, [GAO/T-GGD-97-187](#) (Washington, D.C.: Sept. 30, 1997); and *Federal Employees' Compensation Act: Issues Associated with Changing Benefits for Older Beneficiaries*, [GAO/GGD-96-138BR](#) (Washington, D.C.: Aug. 14, 1996).

from the current FECA benefit structure to a FECA annuity. The presidential commission concluded that the Service should be provided relief from FECA provisions creating costly unintended consequences and that its workers' compensation program should be made more comparable to programs in the private sector. For example, the commission noted that unlike most private sector plans, FECA imposes no waiting period before benefits begin. The commission also pointed out that there is no maximum dollar cap on FECA payments, so that employees eligible for retirement often opt to stay on the FECA rolls rather than retiring. The current approach is costly and provides certain perverse incentives. As a result, we believe that placing workers' compensation benefits on a par with those in the private sector merits careful consideration.

Pay Comparability Issues

The most thorny issue in collective bargaining today is pay and benefit comparability. Although the parties disagree about whether a wage and benefit premium exists and about the basis for making these comparisons, the Service's ability to control costs in this area will be critical to achieving a financially viable organization that can maintain affordable postal rates. One of the limitations in the existing collective bargaining process is that the interests of postal ratepayers do not appear to have been sufficiently considered. One option recommended by the presidential commission was to amend the law to mandate that a regulatory body clarify the term "comparability." In our view, Congress could revisit the statutory comparability standard so that it would more fully reflect the ratepayers' interests and the Service's overall financial condition and outlook. Comparability could be specified to include total wage, compensation, and benefit costs, as well as the relationship of these costs to total costs, their impact on rates and revenues, and the Service's overall financial condition.

Some key questions related to the human capital area include the following:

- Should postal ratepayers or taxpayers pay for postal pension benefits attributable to military service of postal workers? Should this issue be resolved in a consistent manner for the Postal Service and other federal agencies that are also self-supporting?
- Should postal retiree health benefits be prefunded rather than paid on a pay-as-you go basis, and if so, to what extent? Should this issue be resolved in statute or delegated to an administrative or regulatory process?

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- Should workers' compensation benefits for Service employees be greater than those generally available to private sector employees? What other opportunities exist to provide incentives to minimize workers' compensation costs?
 - Should existing statutory standards for comparability of postal wages and benefits be clarified to include specific performance criteria and factors upon which a comparison must be made, such as the Service's overall financial condition and outlook? If comparability standards are retained, what mechanisms should be required for independent reporting and oversight?
 - Should the statutory pay cap on postal executives be lifted, and if so, how would executive pay be linked to performance? Should additional disclosure and/or independent reviews be mandated in this area?

Chairman McHugh, that concludes my prepared statement. I would be pleased to respond to any questions that you or the Members of the Special Panel may have.

Contact and Acknowledgments

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