

**STATEMENT OF
POSTMASTER GENERAL/CEO JOHN E. POTTER
BEFORE THE
SUBCOMMITTEE ON FEDERAL FINANCIAL MANAGEMENT,
GOVERNMENT INFORMATION, FEDERAL SERVICES AND INTERNATIONAL SECURITY
OF THE
COMMITTEE ON HOMELAND SECURITY
AND GOVERNMENTAL AFFAIRS
UNITED STATES SENATE**

JANUARY 28, 2009

Good afternoon, Mr. Chairman and members of the Subcommittee. I appreciate the opportunity to talk to you today about the state of the business at the United States Postal Service and the extraordinary nature of the challenges we are facing. Simply put, the Postal Service is in acute financial crisis.

My testimony will begin by explaining the causes of our current financial challenges. Next, I will discuss the actions we have been taking to meet these challenges. Finally, I will outline the help we are requesting from Congress to weather this storm. Specifically, I am asking for flexibility in the number of days we deliver mail and an eight-year adjustment to our funding schedule for retiree health benefits.

As you know, the Postal Service is a vital economic engine in our national economy. We are not only the nation's second-largest employer, but the mail drives millions of jobs in a wide range of industries in every corner of the nation. The mail drives commerce, both through what it contains and because of its interdependency with so many complementary elements of the nation's infrastructure. The mail system is a nationwide logistics network second to none. Working to protect the viability of the mail will produce benefits that reach far beyond the boundaries of the Postal Service.

The cause of the financial situation we are facing is two-fold.

A revolution in the way people communicate has structurally changed the way America uses the mail. For the last decade, we have experienced a steady erosion of First-Class Mail – one of our highest-margin products – as billings, payments, statements, and personal and business correspondence continue to shift from the mail to electronic communications.

Over most of the same period, there was strong growth in our Standard Mail product – one of the most effective advertising channels in America. In 2005, for the first time, Standard Mail volume exceeded that of First-Class Mail.

Yet, while it remains our volume leader today, lower-cost Standard Mail produces only about half the revenue, overall, as First-Class Mail, and it is extremely sensitive to fluctuations in the economy. Standard Mail volume would have to double to generate the same revenue as First-Class Mail. That level of growth, never experienced even in a strong economy, is unachievable in an economy marked by a severe downturn in advertising.

The economic premise of our system, envisioned by the Postal Reorganization Act of 1970, had long been that ever-growing mail volume would produce the revenue necessary to support a mail processing and delivery network that must expand to serve up to two million additional homes and businesses each year. For more than three decades, that business model contributed to the development of a self-supporting postal system, one that satisfied the statutory mandate that it break even over time, and one that has not received an operational subsidy since 1982.

With the rise in electronic communications driving profound and permanent changes in the mail mix as we entered the new century, it became clear that this model was being rendered obsolete. Change was necessary. Congress, working closely with the entire range of postal stakeholders, enacted legislation in late 2006 that was intended to provide the Postal Service with product and pricing tools that would provide the flexibility needed to operate successfully in a more dynamic, competitive communications market.

Yet, by December 2007, barely one year into our efforts to implement the complex provisions of the Postal Accountability and Enhancement Act, we began to see disturbing new trends in mail volume, reflecting weaknesses in the financial, housing, and credit industries. Historically, these sectors have been among the strongest generators of mail.

Although the financial situation of the Postal Service is grave, it would have been even more untenable if it were not for the aggressive actions we have taken to protect the organization's viability. Those actions began long before we began to see the effects of today's economic distress.

For more than 200 years, the Postal Service had been a tradition-guided, rule-bound, risk-averse organization. With a monopoly based both on law and the practical fact that there was no real alternative to hard-copy postal mail delivery, there was no compelling need for the organization to change its approach.

That world ended as we neared the 21st century. By 1999, understanding that our old business model would be unsustainable in a new, wired world, the Postal Service embarked on a journey of transformational change. The velocity of that change has increased every year as we continue to test the limits of what is possible with the limitations of law and regulation.

We set our sights on achieving previously unimagined efficiency in our operations. This resulted in eight consecutive years of strong productivity gains, producing the equivalent of billions of dollars in cost savings.

These gains, more substantial than the total productivity growth experienced over the previous three decades, were interrupted only after we began to experience the profound effects of the growing economic downturn.

Over time, the effects of the structural shift in communications became increasingly apparent, requiring an acceleration of our cost-management activities. By 2002, we had embarked on a program that ultimately reduced our base costs by \$1 billion annually, resulting in cumulative cost reductions approaching \$20 billion. That included reducing our career workforce by more than 120,000 positions – through attrition. Last year's \$2.2 billion in cost reductions built on that record savings of an additional 50 million workhours.

Our experience over many years has shown that mailing activity is a leading indicator of changes in broader economic cycles. With that in mind, and seeing the economy's continued deterioration as we moved into 2008, we acted quickly to adjust our 2008 financial plans, doubling already aggressive cost reduction goals to \$2 billion – a goal we not only met, but exceeded. This prevented a loss that could have approached \$5 billion.

Yet even these efforts could not keep pace with extraordinary, upward cost pressures. They were led by record-high fuel prices for our more than 220,000 motor vehicles and 37,000 facilities; contractual cost-of-living allowances for our almost 600,000 bargaining-unit employees, reflecting a sharp rise in consumer prices; and a congressionally mandated \$5.4 billion annual funding payment for the Postal Service's share of retiree health benefits.

In fiscal year 2008, total mail volume fell by more than 9 billion pieces – 4.5 percent. With volume down significantly, revenue did not meet projections, even with a May price adjustment, and remained essentially flat compared to the previous year. Costs, however, continued to grow, at a rate far higher than could have been anticipated.

While we reacted as quickly as we could to declining volumes and the economic downturn, some costs were completely beyond our control, most notably the huge prefunding requirement for retiree health benefits and the largest Cost of Living Adjustments (COLA) in our history, required by the collective-bargaining agreements with our craft unions. We simply could not cut costs fast enough to meet these obligations and remain profitable.

The Postal Service is the only public or private entity required to prepay health benefit premiums at these extremely high levels. And, if our payment obligation reflected Generally Accepted Accounting Principles (GAAP), the Postal Service would not be required to make these payments.

All of these factors contributed to a greater-than-expected net loss of \$2.8 billion last year.

Among the cost-management initiatives we took last year was a halt in the construction of new postal facilities in 2008. The limited facilities funds that are now available will be directed only to those sites with the most critical needs. This includes buildings badly damaged or destroyed by natural disasters, locations where we have lost our lease, or sites with severe safety deficiencies that cannot be abated by repair or alteration.

In the last round of contract negotiations, which resulted in new collective-bargaining agreements for our four major unions, we agreed to a new formula for the funding of health care benefits for current employees. This increases the contribution employees make toward their health care benefits by one percent a year. This will continue for the life of the contracts and will help to reduce Postal Service costs.

Working with the National Association of Letter Carriers, we recently concluded a historic agreement that helps us to improve the efficiency of our operations in the face of declining mail volume. The interim agreement establishes a new process for evaluating and adjusting delivery routes, resulting in a quickly implemented one-time adjustment to reflect workload loss. This offers an important advantage over the regular route-inspection process which, under normal circumstances, can be longer and somewhat more arduous. In expediting this procedure, the accelerated route adjustments helps us to achieve operational savings sooner than had been possible. The process, which began in 2008, is continuing this year. Ultimately, it will involve the evaluation of 90,000 city delivery routes.

I have also frozen the salaries of all Postal Service officers and executives at 2008 pay levels. Executive leadership in the Postal Service has an obligation to help send a message of change throughout the organization, demonstrating that they, too, have a personal stake in working to overcome the challenges we are facing.

We are in the process of reducing the authorized staffing complement at national headquarters by 15 percent. And earlier this week we announced that we will be taking similar actions in the field, reducing authorized complement at our nine Area offices by 19 percent. These are our key field administrative units, with responsibility for operations in a number of surrounding states.

We have cut travel budgets across the board and we are using the latest web and video conferencing technology to conduct meetings and share important information. Given the size and scope of our organization, we can realize significant savings in direct travel costs, lodging, and event support.

We are also pursuing needed efforts to consolidate some duplicative mail-processing operations while protecting service. This supports improved efficiency and a greater return on our processing-equipment investments – which generally were made with an eye toward increased, rather than decreased, mail volume.

In this regard, we continue to review our processing needs and capacities to determine which operations from multiple locations can be combined at a single, central facility. This generally involves only the relocation of a single aspect of the work performed at a particular sorting facility, although in some cases operational needs and unique conditions may support the closing of a facility by completely merging its operations with another.

The bulk of our processing and sorting operations are performed at some 400 large, special-purpose mail processing plants. These are separate and distinct from our network of local, retail Post Offices. A well-defined Area Mail Processing policy, developed to support consistency and a fact-based decision process for consolidations, guides us as in our efforts to maximize operational efficiency and capitalize on the economies of scale associated with advances in automated mail processing.

Over the last several years, changing transportation and operational requirements have made it possible to **withdraw operations from 58 Airport Mail Centers**, allowing us to close these facilities and avoid the high costs of leasing facilities on airport grounds. The need for these facilities was reduced as new air transportation contracts placed more mail on the flights of dedicated shippers rather than commercial, passenger carriers.

We also took a hard look at our actual transportation use and found that much of the mail that had been moving by air could meet its service standards through less-expensive ground transportation. By reducing our need for air carriage, we also reduced our need for Airport Mail Centers. Throughout this process, whether moved on the ground or in the air, mail continued to achieve record service performance.

In seeking even greater operational efficiency – whether by consolidating some aspect of a facility's processing activities or phasing out all operations at a particular location – we share information with our customers, our unions, our suppliers, and the communities affected.

We also consider the effect on our employees and work through the contractual provisions that govern these activities. It is important that our decisions are informed both by the interests of our stakeholders and by a realistic response to the extreme financial pressures that are affecting us.

In this regard, I believe that one of the primary interests of our stakeholders is a viable Postal Service not only today, but long into the future. Our consolidation activities, which do affect the way mail is processed in local communities, support the critical goal of protecting our ability to provide quality service to every community. Congress, in enacting the Postal Accountability and Enhancement Act, was clear in its expectations that the Postal Service operate in a more businesslike way than ever before. The Act itself underlines those expectations through provisions that address and encourage activities in this important area.

Our experience has shown that there is strong, overall stakeholder support for the general issue of improved postal efficiency. However, that support often weakens considerably when a specific change is proposed for a specific community. As we move forward, I ask for your understanding and your support of necessary actions that, in promoting efficiency, help us to build a stronger future.

Throughout the entire Postal Service, we remain focused on a systematic, data-driven approach to cost-cutting. **We have targeted \$5.9 billion in potential cost reductions in 2009 and 2010.**

In just the first few months of the current fiscal year, we have used 27 million fewer workhours than the same period last year. I am extremely grateful for the exceptional efforts of all of our managers and employees in capturing these savings so quickly, while providing extraordinary service. But that is only the beginning – we have challenged the organization to eliminate 100 million workhours this year, doubling last year’s remarkable achievement. I believe this is possible.

Looking ahead, and considering a very uncertain future economic climate, it is clear that the problems we are facing are intensifying. The ability of the Postal Service to continue to fulfill its universal service mission is our primary concern. We are doing everything within our power to reduce costs and maintain a system capable of delivering to our nation’s 150 million families and businesses each day. Despite our best efforts, we know that this may not be sufficient to close the widening gulf between revenue and costs.

Some have suggested that an exigent price increase, which would provide us the ability to increase rates beyond the statutorily-imposed price cap, would be appropriate. We do not agree; this would be counterproductive, particularly in an environment where mailing activity has already severely contracted.

This position reflects our experience in 2007 when the Postal Regulatory Commission issued a recommended decision raising prices for Standard Mail catalogs well beyond our original proposal. The result was a substantial drop in catalog-mail volume, demonstrating that driving prices above the rate of inflation can result in mailers reducing the number of pieces they mail. Our interest is not in pursuing an exigent price increase to find new revenue, because we believe that driving up prices will only drive customers away.

Our approach in shoring up the foundations of our business – to ensure that the Postal Service is able to serve America in the future – cannot be singularly focused on cost-cutting measures. Revenue growth that is based on business growth – not simply price increases – is also a key element that is necessary for our long-term viability. This is an important consideration as we begin to implement the new pricing tools made possible by the Postal Accountability and Enhancement Act.

Accordingly, we have taken several major steps to build our business. In 2008, for the first time, we created new, discounted list prices for commercial users of Express Mail and Priority Mail, encouraging volume retention and growth. For our Parcel Select product that offers “last mile” door-to-door delivery, we created pricing and volume incentives that promotes volume growth for large and medium shippers.

And just this month, we further expanded our Express Mail and Priority Mail offerings to include a second level of commercial pricing. This new pricing feature, “Commercial Plus,” is designed to attract a greater number of larger customers to our premium products.

Last year’s major restructuring of our international services streamlined our offerings, more closely aligning them with their domestic counterparts. This supports growth by increasing ease-of-use and providing a better understanding of our comprehensive and competitive global product line.

We realigned our organizational structure in 2008, creating a new Mailing and Shipping Service division that will help us bring new products to market more quickly and effectively. This will strengthen the position of the Postal Service in an extremely competitive marketplace.

Following last year's decision by DHL to reduce its United States operations, we initiated an aggressive outreach effort to make the Postal Service the shipper of choice for former DHL customers. We are also creating a dedicated sales force that will exclusively promote our expedited shipping services, which offer exceptional customer value.

We have also begun a major redesign of our website, *usps.com*. The new format will make it easier than ever for customers take advantage of our services. A number of changes to the site have already been implemented, giving it a clean new look, easy-to-navigate features, as well as improved and expanded functionality. This will position our *usps.com* as a more valuable growth channel than ever.

This month, we adopted a new, annual price-adjustment schedule for shipping services – our competitive products portfolio. This aligns the Postal Service's prices adjustments for shipping services with the standard industry practice of annual price changes every January. All shippers will benefit by having all the pricing information they need to make cost comparisons at the same time each year.

We have worked hard to position the Postal Service for growth in an intensely competitive delivery market, making full use of the new tools Congress made available to us through the Postal Law of 2006. Since that time, however, general business conditions have deteriorated to the extent that the domestic shipping business is contracting, not expanding.

While I am enthusiastic about the potential of these new product and pricing tools, particularly in an improved economy, I am extremely concerned about our ability to maintain a comprehensive, nationwide mail system in a staggering economy that shows no signs of recovery and simply has not been conducive to growth.

In many ways, our situation is similar to that faced by many governors and mayors. They, too, are struggling to meet the expense of providing basic public services with shrinking budgets. Growing unemployment, a slowdown in business and consumer spending, mortgage foreclosures, reduced construction activity, and mergers and closures in the banking and retail sectors have constrained the traditional and primary sources of state and city government revenue. These are many of the same factors that have brought the Postal Service to its present, tenuous situation.

But, in reacting to the extreme demands of today's economy, state and local officials have a level of flexibility and options that are simply not available to the Postal Service. Pay is being frozen or reduced. Service levels are being cut. Libraries, motor vehicle agencies, and other state and city offices have reduced their hours and days of operation.

Workforce flexibility in the Postal Service, defined by the collective-bargaining agreements with our unions, is more limited. The agreements were negotiated while our economy was growing, while postal productivity was increasing, and while our finances were strong. For that time, their provisions represented an appropriate mechanism to share our success with the people who helped us to achieve it. But, in a drastically changed environment – one that could not be foreseen at the time – those same provisions, by limiting the options available to us in responding to the current crisis, can have the unintended effect of working against the future security and well-being of our employees.

Over the last year, round after round of layoffs, in both the public and private sector, have helped to reduce the costs of employers who have had to adjust to a contracting economy. We want to continue working with our unions to seek more positive, win-win solutions.

Contracts with the two unions that alone represent almost 75 percent of our 652,000 career employees – the American Postal Workers Union and the National Association of Letter Carriers – do not expire until late 2010 and late 2011. We cannot wait until then to address what are pressing needs today. So I am proposing to union leadership that we begin talks now to create needed levels of workforce flexibility.

We are proud of the fact that, even as we sharply reduced our use of resources, our service levels reached an all-time high last year, including 97 percent on-time delivery performance for overnight-committed First-Class Mail.

But in working to keep performance strong, the strain on our operations becomes more apparent every day as we consider what additional steps we can take to survive a financial crisis that appears only to deepen. We have stretched the limits of our system as they have never been stretched before. Without help, I do not believe we can long serve the people of America with the level and quality of service they expect and deserve.

The Postal Service is a unique institution. While it must operate like a business, competing in a marketplace that includes some of the world's most respected and successful businesses, it must also fulfill an important public service role. That is a role we embrace.

We must serve every customer and every community equally. Rich or poor, from the biggest cities to the smallest towns, we must provide the same high level of service. We must provide the same access. We must make our services available at the same price – in both easy-to-serve locations and locations so remote they can only be reached by mule, by swamp boat, or by bush plane.

The Postal Service is today, and has always been, the link that connects every American – no matter who, no matter where – to every other American, for only the price of a stamp and an address. We cannot put this at risk.

We are doing our best to manage through the immediate crisis. We have been adapting quickly as mail volume falls, matching workhours to a declining workload, and reducing costs in every operating and administrative unit. Doing the right things today will leave us very well positioned for an eventual economic recovery. As mail volume returns, we will ramp back up only at the rate necessary to protect productivity, keeping costs down so that operating revenue goes as far as possible.

Today, however, we are still chasing volume – which is falling faster and faster, outpacing the speed at which we can adjust operations. No one knows at what point mail volume will bottom out.

As the service needs of America change, we must change along with them. We must provide the products our customers want, when they want them and how they want them. While they have embraced new communications technology, Americans still rely on the mail, and they trust it like almost nothing else – more than 500 million times each day. They expect us to be there for them. Without the mail, a still-vital piece of our nation's infrastructure, our nation would be the poorer. We cannot let that happen. Therefore we are turning to Congress for help.

We expect no improvement this year; rather, our projections anticipate a continued deterioration of our financial situation. Our financial plan, which forecast an additional decline of 8 billion pieces of mail this year, has been revised to reflect an even steeper decline. Volume is now expected to plunge by some 12 billion to 15 billion pieces, based on actual mailing activity during the first quarter. Preliminary quarter-one financial results show that revenue is down approximately \$1.3 billion – 6.5 percent – from the same period last year. We expect that 2009 will be the first time that we have recorded a year-to-year revenue decline since 1946.

If current trends continue, we could experience a net loss of \$6 billion or more this fiscal year despite the most aggressive effort in our history to take cost out of our system. The maximum loss we can absorb while allowing us to meet all of our obligations under current law and close the year with a positive cash balance is \$5 billion. The gap between where our net income is trending and our projected cash position is a cause for alarm and is causing us to make some very difficult choices.

Continued deterioration of the economy may depress mail volume and revenue even further than we expected, for a longer period than we expected. If this should be the case, the Postal Service must find additional opportunities to eliminate costs. So far, we have been able to do this without affecting service. But the situation demands that we also examine options that had previously been off the table. Over the years, we have taken great pride in accomplishing our mission of serving everyone, everywhere, every day. This has been at the center of our universal service mandate.

As we look at our business through the lens of today's new reality, we also recognize that our efforts as an organization may, by themselves, be insufficient. We believe that legislative relief is necessary to preserve the nation's mail system.

First, it is possible that the cost of six-day delivery may simply prove to be unaffordable. If that should occur, it could become necessary to temporarily reduce mail delivery to only five days a week. We would do this by suspending delivery on the lightest volume days. Toward this end, I reluctantly request that Congress remove the annual appropriation bill rider, first added in 1983, that requires the Postal Service to deliver mail six days each week.

Any such action would be taken under the direction of our Board of Governors and only when absolutely warranted by financial circumstances. Were we to do so, we would make every effort to maximize the benefits to our customers while minimizing any disruption to our mailers.

Second, we are asking for a legislative change to provide relief from the crippling cost burden imposed by the law's requirement that we prefund the employer premium for the health benefits of future retirees while continuing to pay health care premiums for our current retirees. This, in no way, removes our obligation to satisfy this basic benefit funding need – nor should it. What it does do, by transferring the current premium payments to the fund, is improve our financial position and cash flow significantly. This will free up a tremendous portion of operating revenue to offset our current operating expenses. Let me explain details.

That funding schedule, established by the Postal Accountability and Enhancement Act, was a difficult stretch even before we entered the current recession. It requires annual payments ranging from \$5.4 billion to \$5.8 billion over the ten-year period from 2007 through 2016.

In 2008, our total retiree health benefits costs came to \$7.4 billion – \$1.8 billion paid to the Office of Personnel Management for current retirees, and \$5.6 billion deposited into the Postal Service Retiree Health Benefit Fund to prefund future premium payments. That represented almost ten percent of last year's operating budget. We are facing higher costs this year.

Without the payment mandated by the Act to prefund retiree health benefits, the Postal Service would have achieved a positive net income in 2008 – rather than our actual \$2.8 billion loss. That is particularly significant in light of the fact that no other entity – public or private – is required to prepay this health benefit obligation at these extremely high levels. These prepayment amounts are not directly related to the actual cost of these benefits or the total unfunded obligation; rather, they reflect budget “scoring” issues, developed to maintain the Act’s budget neutrality.

While we recognize that budget neutrality can be an important public policy goal, we believe, in this case, there is an urgent need to balance current responsibilities against future responsibilities. Our proposal creates the needed balance.

We are in uncharted waters. But we do know that mail volume and revenue – and with them the health of the mail system – are dependent on the length and depth of the current economic recession. We are encouraged that Congress and the White House continue to take focused steps to address the nation’s financial crisis. However, no one can yet predict when the economy will recover or the actual strength of a recovery.

To ease our immediate financial crisis, the Postal Service proposes that Congress provide legislative relief by amending the Postal Accountability and Enhancement Act. Our proposal would retain the ten-year payment schedule, but would permit the Office of Personnel Management to pay the Postal Service’s portion of health benefit premiums for current retirees from the Postal Service Retiree Health Benefits Fund. This would save the Postal Service up to \$24.6 billion through 2016.

This change would not increase the health benefit premiums paid by current or future Postal Service retirees, nor would it affect their benefits.

The Postal Service Retiree Health Benefits Fund has a balance of \$32 billion. By paying current retiree health premiums from the Postal Service Retiree Health Benefits Fund rather than from operating revenue, an additional \$2 billion would be available to offset other costs in 2009. This would significantly improve our balance sheet and strengthen our business, protecting our long-term ability to contribute to the funding of health benefits for our retirees.

I come before you today with only one agenda – to ask for your support in preserving an effective, affordable Postal Service, capable of serving every American in every community, and one that remains an important economic driver, for many years to come. We cannot accomplish this goal without your help.

These are extremely challenging times – for the nation and for the Postal Service. As I have explained, we have done a great deal to preserve the future of our nation’s mail system. But there is more to be done and we must do it together. From my perspective, nothing is off the table; we must achieve each one of the following actions.

Success is dependent on working with our unions to achieve necessary workforce flexibility.

Success is dependent on our mailers providing us with mail that can move more efficiently through our system.

Success is dependent on even better management of workhour usage.

Success is dependent on bringing maximum transactional ability to our website – our lowest cost channel.

Success is dependent on driving mail volume up.

Success is dependent on an economic recovery.

And, finally, success is dependent on Congress providing the relief I have asked for today – in delivery flexibility and retiree health benefit payments.

I appreciate your consideration and I thank you for inviting me to discuss these matters with you. I would be pleased to respond to any questions you may have.

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