Testimony of

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to a hearing titled "Solutions to the Crisis Facing the U.S. Postal Service" by the Senate Committee on Homeland Security and Governmental Affairs

February 13, 2013

I. Introduction

I am Fred Rolando and I serve as the President of the National Association of Letter Carriers (NALC), a union that represents nearly 190,000 City Letter Carriers who live and work in every state and jurisdiction of the United States. I regret very much that the HSGAC Committee could not accommodate my request to testify in person on February 13, 2013, though I appreciate and readily acknowledge that the Committee invited me to testify on the originally scheduled date of February 6, 2013 – a date on which I was scheduled to be out of town for a national leadership conference. I therefore submit this testimony in writing on behalf of the 265,000 active and retired letter carriers who have voluntarily joined our union, including more than 90 percent of all active City Letter Carriers.

Letter carriers are rightly proud of the value we deliver to the American economy every day. The Postal Service offers excellent services at the most affordable rates in the world. Postage rates in the United States are 50-100 percent less than they are in Europe, even though we serve a geographical area that is much larger than any served by any European Union postal operator. And the quality of our service is rated among the best in the world. Indeed, a 2012 study of postal services in the G-20 group of nations by Oxford Strategic Consulting of the U.K. concluded that the USPS is the best postal service among the world's wealthiest countries (see Attachment 1 for the Executive Summary of the report).

Although mail volume is declining, and alternative forms of communication are taking the place of mail, the Postal Service remains a vital component of this country's economic and communications infrastructure. In the last fiscal year, USPS still handled 160 billion pieces of mail. Almost one half of all bills are still paid by mail. The majority of bills and statements received by households are still delivered by mail. Trillions of dollars move through the postal system every year. The Postal Service, despite its losses, generates annual revenue in excess of $65 billion. The mailing industry employs 8 million Americans. In September, 2011, Postmaster General Donahoe accurately described the importance of the Postal Service to the overall economy in testimony before this Senate committee:

> The importance of a healthy and thriving Postal Service cannot be overstated. The mailing industry, of which the Postal Service is only one component, depends on the continued evolution, growth and development of our organization. Over 8 million Americans are employed by thousands of companies and businesses which are deeply invested in the mail. The mailing industry, with the Postal Service at its core, is a major driver of the nation's economic engine—generating over $1 trillion each year. Our collective actions—particularly those of the Postal Service and Congress—to secure the future of the nation's postal system will directly affect a significant portion of the American economy. The mailing industry makes up approximately seven percent of the country's Gross Domestic Product (GDP). Failure to act could be catastrophic.

Although we very much oppose the direction the Postmaster General is leading the Postal Service, we do agree with him on this. Now is the time for Congress to act to preserve America's great Postal Service.

II. Origins of the Crisis

The crisis facing the Postal Service is now in its sixth year. Although there are serious underlying factors driving the postal crisis, the scale and severity of this crisis is largely due to past actions taken by Congress. In 2006, the Congress passed and President George Bush signed the Postal Accountability and Enhancement Act (PAEA) of 2006. That legislation mandated a massive level of pre-funding of future retiree health benefits with a schedule of annual payments totaling $59 billion over the next 10 years with additional pre-funding thereafter to be amortized over 40 years initially, and eventually over 15 years as the amortization period was reduced. (The $59 billion figure was upper end of the estimated unfunded liability for such benefits over the next 75+ years – see page 29 of the 2006 USPS Annual Report.) The PAEA also placed strict price controls on the postage rates charged for magazines, catalogues, and letter mail (so-called market-dominant products). The new law gave the Postal Service a one-time-only option to adjust postage rates in 2007 to build the cost of the new pre-funding mandate into its prices before the new price index system kicked in (in an omnibus rate proceeding before the Postal Regulatory Commission). But the onset of what turned out to be the worst recession in 80 years led the USPS to forego that option. So USPS costs soared at a time when its revenue plummeted as the economy crashed.

Though well-intended and enacted at a time when the Postal Service was earning profits, the PAEA had a disastrous effect on the Postal Service. In a kind of perfect storm, the agency's finances were devastated by the pre-funding mandate, the price controls and the Great Recession that decimated the housing and finance industries which generate so much mail volume. On top of all this, surging fuel costs and the loss of First Class Mail to electronic bill-paying and internet communication added to the losses.

In the popular media and, unfortunately in many of the statements issued by members of Congress, the fiscal crisis at the Postal Service is often portrayed as a simple story of technological change. Although internet diversion is a serious and growing problem, not least because the ongoing crisis at the USPS seems to have accelerated the trend, it is not the main driver of USPS losses in recent years. As Table 1 indicates, nearly 80% of the Postal Service's $41 billion in reported losses stem from the $32 billion in pre-funding costs since 2007:

Table 1.

The Policy Legacy of the 2006 Postal Reform Bill (PAEA)

Pre-funding Payments to the Postal Service Retiree Health Benefit Fund (PSRHBF) vs. Reported Net Income

2007-2012*

Year	PSRHBF Expenses ($bil)	Reported Net Income ($bil)	Assets in PSRHBF ($bil)
2007	$8.358	-$5.142	$25.4
2008	$5.600	-$2.806	$31.8
2009*	$1.400	-$3.794	$34.2
2010	$5.500	-$8.505	$40.6
2011*	$0.000	-$5.067	$42.5
2012	$11.1	-$15.900	$45.0
Totals	$31.958	-$41.214	—

Prefunding expenses account for nearly 80% of reported USPS losses over the past six years since they were first imposed in 2007.

Notes: * Legislation adopted in 2009 reduced the 2009 pre-funding expense from $5.4 to $1.4 billion. Legislation adopted in 2011 deferred the $5.5 billion payment for 2011 until August 2012. USPS was unable to make the $11.1 bil. payment in 2012.

Sources: Annual Reports of the Postmaster General, 2007-2012.

In the first quarter of the current fiscal year, the Postal Service earned a profit of $100 million, but reported a loss of $1.3 billion after recognizing a $1.4 billion expense for pre-funding. Meanwhile, as other delivery companies were able to raise rates to handle rising gasoline prices and other overhead costs, the Postal Service was prohibited from raising rates above the very low levels of inflation experienced during the Great Recession – see Table 2:

Table 2.

Consumer Price Index:
CPI-Postage vs. CPI-Private Delivery

Year	CPI-Postage	CPI-Delivery Services (private delivery)
2007	2.5%	6.4%
2008	3.4%	14.7%
2009	4.9%	-6.2%
2010	2.8%	14.2%
2011	3.9%	11.7%
2012	3.5%	5.3%
Avg. Inc. (2007-2012)	3.5%	7.7%

Source: Bureau of Labor Statistics, Consumer Price Index.

- Postage rates for most USPS volume were capped at the general rate of inflation even though the pre-funding mandate caused costs to soar.
- Shared sacrifice requires the use of a more relevant price index: CPI for Delivery Services which tracks delivery prices in the private sector.

The pre-funding mandate, which no other business or governmental agency faces, not only crippled the Postal Service's finances, it also led the Postal Service to pursue relentless downsizing and service cuts that are driving even more mail volume out of the system. Rather than use its borrowing authority to retool to capture new volume in the booming e-commerce industry or find new products to offer through its unmatched first-mile and last-mile delivery networks, the Postal Service has used it all to cover pre-funding costs. Worse, postal management has been hunkered down in crisis mode ever since the mandate took effect, devising ever more draconian reductions in service that threaten to plunge the Service into a death spiral – where declining volume begets service cuts, prompting ever further volume losses and new service cuts.

Over the past few years, the USPS has removed tens of thousands of collection boxes and is reducing operating hours in more than 10,000 post offices, weakening its first mile network and driving away more business. Now it wants to degrade its last-mile delivery network by cutting Saturday delivery in August. Indeed, last week the Postmaster General outrageously announced his intention to implement five-day service for mail and six-day service for packages even though Congress has mandated six-day delivery of all mail for some 30 years. That mandate remains in current law. The PMG gave us less than 24 hours notice and personally told me he plans to go ahead with his plan even if Congress extends the current Continuing Resolution. He apparently thinks he's above the law; and has refused to work with NALC on operational, legislative, or customer service matters. The members of the NALC have lost confidence in Postmaster General Donahoe – indeed the 7,000 elected delegates of the NALC biennial convention in Minneapolis unanimously adopted a "motion of no confidence" in July 2012. For these reasons, and because we are convinced that the business strategy the Postmaster General is following is doomed to failure, we have called for the PMG's resignation.

We respectfully think you should do so too.

It gives us no pleasure to take this position. But our members and other postal employees have made tremendous sacrifices in recent years to save the Postal Service and those sacrifices should not be made in vain. NALC worked cooperatively with the Postal Service during the Great Recession to adapt to plunging mail volume. We eliminated more than 12,000 routes even as we added more than more than three million new delivery points. Over the past dozen years, we have boosted city carrier productivity dramatically, increasing average delivery addresses per route from 492 in 1999 to 616 in 2012, an increase of more than 25 percent. This has meant increasing the physical demands of our jobs by extending the hours we work on the streets from four hours to more than six hours a day, in all weather conditions. (Note that once the economy stabilized, the Postal Service unilaterally walked away from the joint process we used during the recession.)

In fact, the Postal Service has eliminated more than 193,000 jobs since 2006. And postal employees have not just sacrificed jobs – we have also done our part in recent rounds of collective bargaining to cut costs in the face of declining volume and revenues. City carriers will be paying more for health insurance and new career city carriers will earn 25% less when they are hired, and the Postal Service will be able to hire many thousands more non-career carriers who will make nearly 33% less in wages than current non-career carriers. The other postal unions made similar cost-cutting sacrifices. We have done our part to save the USPS. Now we urge Congress to do its part.

As the Committee deliberates over postal reform, we urge you to reverse or fundamentally modify the PAEA's unintentionally destructive policies on pre-funding and pricing, and to take action to prevent the Postal Service from downsizing the Postal Service into a death spiral by saving six-day delivery. But those steps alone will not save the Postal Service. That will require an even more fundamental restructuring of the Postal Service's governing structure, executive management and regulatory environment to allow the Service to compete for e-commerce volume and to use its unmatchable networks to offer new services. That is the conclusion reached by Lazard Company's due diligence investigation of the Postal Service commissioned by the NALC and conducted in 2012 (see Attachment 2). We hope to advance Lazard's recommendations in the legislative process and NALC looks forward to working with Senators in both parties to find solutions that will preserve the U.S. Postal Service, one of America's greatest institutions.

In this testimony, we will offer our views on a full range of policy solutions to the crisis at the Postal Service. It is our hope that the Committee will hold additional hearings on crucial topics such as reform of the pre-funding mandate, measures to reduce the cost of postal employee health benefits, new products and pricing reforms, and the debate over Saturday delivery.

II. Repeal or Reform the Mandate to Prefund Future Retiree Health Benefits

It is strange, but true, that the Postal Service is the most financially sound, failing company in America. Its pension obligations (under CSRS and FERS) are over-funded, even in the face of pension cost allocation methods developed by OPM that are grossly unfair to the Postal Service (according to independent, private sector audits that are discussed below). It has also prefunded 49% of its future retiree health benefits. No other civilian agency in the executive branch has pre-funded these costs at all, and according to a recent Towers Watson survey of Fortune 1000 companies, only 38% of such private companies prefund at all and the *median* level of funding is just 37%. In the private sector, pre-funding is voluntary. Responsible companies pre-fund when they are profitable or use their surpluses in their pension funds to cover such costs, as encouraged by the tax code.

Unfortunately, the PAEA's uniquely burdensome prefunding mandate is literally killing the Postal Service. Implemented at the outset of the global financial crisis, the excessive level of pre-funding required by the PAEA has consumed all of the Postal Service's borrowing authority and has pushed the agency to the verge of insolvency. No private company would have funneled tens of billions of dollars into a retiree health fund in the midst of a deep recession. The Postal Service needs immediate and significant relief from this mandate – without it, no other reform can save this institution.

In the last Congress, the Senate did attempt to reduce the pre-funding burden in S. 1789. That bill lowered the target level of pre-funding from 100% to 80%, replaced the fixed schedule of prefunding payments with a two-tier set of pre-funding payments (normal cost payments and amortization payments to reduce the unfunded liability), and opened access to the Postal Service Retiree Health Benefits Fund (PSRHBF) a few years early for use to cover the cost of current retiree health premiums. The last provision provided significant short-term relief from the pre-funding burden, freeing up cash by moving the date the PSRHBF can be used to cover premiums from 2017 to 2012. But the actual level of pre-funding under S. 1789 was reduced by just 6 percent, as shown in Table 3. The level of prefunding would remain very high and the USPS would likely default on the payments required in S. 1789 in a year or two. We believe much more substantial relief is required.

There are a number of options Congress should consider to solve the prefunding problem:

1) Repeal. The simplest solution would be to repeal the PAEA's pre-funding mandate altogether and to allow the Postal Service to use the Postal Service Retiree Health Fund to cover the cost of retiree health premiums with the $45 billion in funds now deposited in the Postal Service Retiree Health Benefits Fund (PSRHBF). Over time, the fund would

Table 3:

PRE-FUNDING PAYMENTS UNDER CURRENT LAW AND S. 1789: CBO ESTIMATES

Current Law – PAEA of 2006 ($billions)

Year		Schedule		Normal		Amortization		Total
2012	$	2.100					$	2.100
2013	$	5.600					$	5.600
2014	$	5.700					$	5.700
2015	$	5.700					$	5.700
2016	$	5.800					$	5.800
2017			$	4.181	$	3.410	$	7.591
2018			$	4.410	$	3.410	$	7.820
2019			$	4.651	$	3.410	$	8.061
2020			$	4.902	$	3.410	$	8.312
2021			$	5.165	$	3.410	$	8.575
2022			$	5.440	$	3.410	$	8.850
Totals	**$**	**24.900**	**$**	**28.749**	**$**	**20.460**	**$**	**74.109**

S. 1789 - 21st Century Postal Service Act of 2012 ($billions)

		Schedule		Normal		Amortization		Total
2012	$	-	$	3.174	$	2.100	$	5.274
2013	$	-	$	3.368	$	2.100	$	5.468
2014	$	-	$	3.560	$	2.100	$	5.660
2015	$	-	$	3.760	$	2.100	$	5.860
2016	$	-	$	3.970	$	2.100	$	6.070
2017	$	-	$	4.181	$	2.100	$	6.281
2018	$	-	$	4.410	$	2.100	$	6.510
2019	$	-	$	4.651	$	2.100	$	6.751
2020	$	-	$	4.902	$	2.100	$	7.002
2021	$	-	$	5.165	$	2.100	$	7.265
2022	$	-	$	5.440	$	2.100	$	7.540
Totals	**$**	**-**	**$**	**46.581**	**$**	**23.100**	**$**	**69.681**
				USPS Savings (2012-2022)			**$**	**(4.43)**
				Pct Change (2012-2022)				**-5.97%**

Source: Report of the Homeland Security and Governmental Affairs Committee to Accompany S. 1789 (Report # 112-143), Table 3, p. 43.

be depleted and the USPS would return to covering these costs from operating revenue on a pay-as-you-go basis. This would give the Postal Service time to restructure and adapt in the intermediate term and eventually allow it to return to the private sector standard on covering retiree health costs for companies in multi-employer plans.

The objection to this alternative is that taxpayers might eventually be required to cover the cost of postal employee retiree health costs, if the Postal Service lacked the funds or ceased to exist. The GAO has emphasized this point in its analysis of the issue. Underlying this concern is the notion that ratepayers must cover all present and future USPS costs, a convention adopted in 1970 and fully implemented by 1983. But for more than 200 years before 1983, the Post Office was funded by taxpayers and ratepayers. To say that we must adhere to the post-1983 convention forever assumes that the tax-paying public receives no benefit from the Postal Service and therefore should never have to pay any of its costs. We believe this assumption is wrong – all Americans benefit from the Postal Service, taxpayers and ratepayers alike. As a public service and as a crucial part of the nation's economic and political infrastructure, it supports national unity and national markets, encourages economic growth, and contributes to the cultural and political life of the nation.

While we do not seek nor support taxpayer operational subsidies for the Postal Service today, we do not believe the fear of a possible need for taxpayer support for retired postal employee health benefits in a doomsday scenario for the future can justify crippling the Postal Service today with an unaffordable mandate. Moreover, no other agency of the government, and I might add no institution or agency in the legislative branch of the government (which includes the House, the Senate, the GAO, the CBO and the CRS) currently pre-funds future retiree health benefits at any level. Future taxpayers will cover the cost of health benefits for retired legislative branch employees. Would future postal retirees be any less worthy of taxpayer-provided health benefits as compensation for their service to the country? The answer is: Of course not.

In any case, retaining a crushing prefunding mandate today makes it more likely, not less likely, that taxpayers will eventually have to cover the cost. Driving the Postal Service into a death spiral will not protect taxpayers. Reform that allows it to restructure and thrive will.

2) Repeal and replace. Another option would be to repeal the PAEA's pre-funding mandate and replace it with a more reasonable and affordable mandate. For example, it could be replaced with a private sector "best practices" funding standard – which would require the USPS to contribute to the PSRHBF in years when it is profitable. The law could dictate a defined percentage of profits be allocated to the PSRHBF or require the USPS maintain a pre-funding percentage tied to private sector practice among firms that pre-fund. Or the law could require the USPS to maintain the level of funding in the PSRHBF to a level tied to best practices in the private sector – the 37% median level of funding among Fortune 1000 companies in the private sector, for example.

3) The USPS OIG proposal. The USPS Office of Inspector General offers a creative solution to the pre-funding mandate. It would repeal the PAEA's prefunding payment schedule and allow the current assets in the PSRHBF to accrue interest over time while the USPS continued to pay for its retiree health insurance premiums with operational funds. The PSRHBF would continue to grow with earned interest and would not be available to the USPS until it covered a certain percentage (to be set by Congress) of the unfunded liability. It would effectively serve as a reserve fund to cover the cost of

retiree health in the future if the Postal Service could not make the payments in the future. This would provide breathing space to reform the USPS and partially address the GAO's concerns, even though it would still treat the USPS more harshly than other agencies and private companies. The proposal is outlined in a letter to Sen. Sanders reproduced as Attachment 3.

4) Cover retiree health with the fairly calculated CSRS pension. During the 112th Congress, bills offered in both the House and Senate, sought to protect future taxpayers from future postal retiree health liabilities by permitting the Postal Service to use postal pension surpluses in the Civil Service Retirement and Disability Fund (CSRDF) reported by independent audits (USPS-OIG/Hay and PRC/Segal) to cover the cost of future pre-funding. Indeed, the only-bipartisan postal bill considered the House of Representatives (H.R. 1351) in the 112th Congress, which drew 230 co-sponsors from both parties, called for fairly and accurately measuring the Postal Service's pension surplus in the postal CSRS account of the CSRDF and transferring the surplus to the PSRHBF. That bill never got a vote in the House. In the Senate, the original bills offered by Sens. Carper and Collins (S. 1010 and S. 353) that were later combined to create S. 1789 contained similar language on the CSRS surplus. However, concerns that transferring funds from the CSRDF to the PSRHBF would present scoring problems led the senators to drop the provision from S. 1789. (The senators may have also reacted to a GAO report that questioned claims that the USPS was over-charged by the OPM for retirement costs, but the same report acknowledged that the PRC and OIG methods were "reasonable" and that the choice of methods used is a "policy decision" for Congress.)

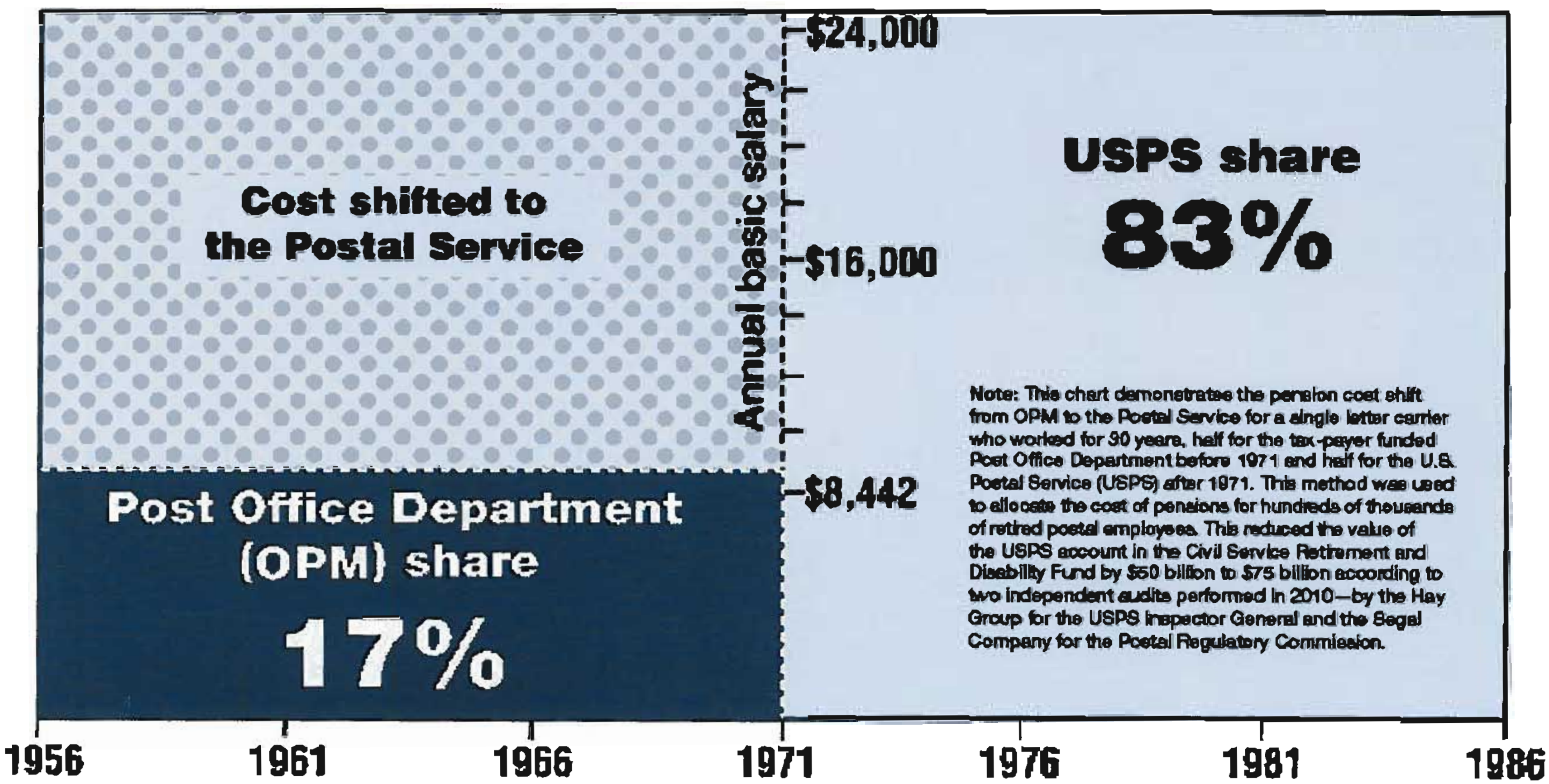
The decision to leave the CSRS transfer provision out of S. 1789 prevented significant relief from the pre-funding burden – which may have driven the bill's authors to target the elimination of 18% of all postal jobs and to lay the groundwork for the elimination of Saturday delivery two years from now (and the subsequent opening of the nation's mail boxes to private competitors). It is crucial to reverse these legislative decisions, and to address the problems that led to them, as we tackle postal reform in the 113th Congress. However, this can be done in a way that minimizes the impact on the deficit that would result from a large transfer from the CSRDF to the PSRHBF. Indeed, it may not be necessary to transfer any funds at all to significantly reduce the cost of pre-funding. This can be done in five steps:

a) In the Office of Personnel Management's annual valuation of the CSRS postal sub-account within the Civil Service Retirement and Disability Fund, mandate the adoption of modern, private sector accounting and actuarial methods called for by Accounting Standard Codification No. 715. (FASB -ASC 715, *Compensation—Retirement Benefits* from the Financial Accounting Standards Board). This was the policy recommendation of the Postal Regulatory Commission's report *on Civil Service Retirement Cost and Benefit Allocation Principles* prepared by respected experts of the Segal Company (June 29, 2010). The methods proposed by the PRC report produce a lower surplus than those advocated by the USPS OIG report on the same matter prepared by the Hay Group in January 2010, *The Postal Service's Share of CSRS Pension* Responsibility (Report Number: RARC-WP-10-001, January 10, 2010). As mentioned above, a GAO review of these reports as well as the accounting and actuarial methods currently employed by the Office of Personnel Management (OPM) concluded that all three sets of methods are "reasonable" and that the choice of methods is a "policy decision." Congress should mandate the PRC's methods because the OPM's current methods are unfair and inequitable to the Postal Service, its customers and its employees. See Chart 1, which

Chart 1.

Forcing the USPS to pay more than its Fair Share of CSRS Pension Costs: How the OPM Defines "50-50"

Example: A Retired Letter Carrier with 30 years of Service



demonstrates the inequitable allocation of pension costs resulting from the OPM's methods. It shows that the Postal Service pays 83% of the health care costs of a retiree who worked just 50% of his career for the USPS, leaving the OPM to pay 17% for the other half of the employee's career for the tax-payer supported Post Office Department.

As suggested above, mandating the PRC audit's reform recommendation had strong support in the last Congress – a majority of the House of Representatives co-sponsored a bill (H.R. 1351) and bills introduced by Senators Carper and Collins at the beginning of the 112th Congress also endorsed these methods. In addition, the Obama administration expressed its support for a CSRS transfer as part of postal reform, as explained in a letter from Director of Legislative Affairs Director Robert Nabors to Representatives Elijah Cummings and Darrell Issa on October 13, 2011. The letter is reproduced as Attachment 4, which was sent <u>after</u> the GAO report on pension allocation methods was issued.

b) In order to minimize any budget impact of mandating the use of fair actuarial methods and assumptions, Congress should repeal Section 1848(h)(2)(C) of USC Title 5, which requires the transfer of any postal pension surplus to the USPS Retiree Health Benefit Fund following valuations in 2015, 2025, 2035 and 2039. The required transfers mandated by 1848(h)(2)(C) were enacted by the PAEA in 2006. A repeal of this transfer provision would eliminate the need to amortize (with mandatory payments from the General Fund) any increase in the CSRDF's unfunded liability resulting from the transfers. (Such amortization payments are required by another provision in Title 5.)

Note: A repeal of the transfer provision would minimize any budget score associated with a policy of accurately and fairly defining the Postal Service's pension obligations and give policy-makers up-to-date and accurate information on the Postal Service's legacy costs. It makes sense because the PSRHBF will not need the surplus funds for decades – and the surplus pension funds might never be needed if Congress enacts the reforms outlined below to properly invest the PSRHBF (item 5) and to find ways to reduce future retiree health benefit costs (item 6).

c) Congress should repeal the PAEA's fixed schedule of pre-funding payments and replace it with the two-tier prefunding payments called for in S. 1789 (normal cost and amortization costs), but establish a right to access the fairly calculated CSRS postal surplus in the future to cover the cost of retiree health benefits if the PSRHBF should ever be exhausted. (The 80% funding target and the immediate access to the PSRHBF to cover current retiree health premiums in S. 1789 should be retained in any new legislation.)

d) Congress should require the OPM Board of Actuaries to take the accurately measured CSRS postal surplus into account when calculating the unfunded liability for postal employee retiree health benefits, a step that would eliminate the need to make amortization payments over the next ten years or more. (In practical terms, the USPS would make a normal cost payment each year to the PSRHBF and the PSRHBF would cover the cost of current postal retiree health premiums – resulting initially in a growing PSRHBF, even before taking into account the fund's earnings.) This instruction would apply the best practice of private sector pension funds to the Postal Service. Indeed, the tax code allows companies to apply surplus pension funds to the cost of post-retirement health liabilities (see section 420 of the Internal Revenue Code).

e) In order to address false claims that might be raised by some that reforms such as those described above represent "taxpayer bailouts," Congress should adopt the Statutory PAYGO reforms proposed by the Obama administration to the Super Committee established by the 2011 Budget Control Act. Section 104 of the administration's submission called for an amendment to the PAYGO act to treat the transactions of the Postal Service Fund as "budgetary effects," thereby measuring Postal Service transactions on a unified budget basis for PAYGO purposes.

5) Invest the PSRHBF in the Thrift Savings Plan. The PSRHBF is unique in the federal government. No other agency has a retiree health fund. Although it differs from so-called VEBA plans (Voluntary Employee Benefit Associations) in the private sector because retired postal employees are guaranteed retiree health benefits by the FEHBP law even if the balance in the PSRHBF goes to zero, it is very similar to such plans since its assets are dedicated to cover benefits for a specific group of people with a tie to a single employer. In this case, the PSRHBF is dedicated to pay the Postal Service's share of health insurance premiums for retired postal employees -- starting in 2017.

Unfortunately, the PSRHBF is invested solely in low-yielding Treasury securities – and given that long-term health care costs are expected to grow faster than the interest rates payable by Treasury securities for the foreseeable future, the unfunded liability will almost certainly keep growing over time. No VEBA in the private sector would invest its assets so conservatively, especially since the annual cash requirement for the PSRHBF ($3 billion per year) is a fraction of the $45 billion in assets.

In an ideal world, the PSRHBF would be held on the Postal Service's books and invested appropriately (in a properly diversified portfolio of stocks, bonds, real estate, etc. overseen by a professional investment manager) to minimize the PSRHBF's unfunded liability – and therefore minimize any amortization payments from the USPS in the future. Transferring the PSRHBF to the off-budget Postal Service might present budget scoring problems (unless the budgetary effects proposal outlined above is adopted) and the Treasury Department has traditionally opposed the investment of government trust funds in private securities.

However, NALC believes there is a way for the PSRHBF to earn higher, private sector-based returns without moving it from the OPM's books – which should reduce the federal deficit. The PSRHBF could be invested in the index funds offered by the Thrift Savings Plan. The Federal Retirement Thrift Investment Board already invests a pool of nearly $300 billion of federal and postal employee retirement savings in these funds – so investing the funds of the PSRHBF, which also holds assets dedicated to post-retirement benefits, would not be setting a new precedent. The TSP's Lifecycle 2040 Fund has earned an annual return of 5.0% since its inception in 2006, much greater than the 2-3% returns paid lately on Treasury bonds.

6) <u>Give the Postal Service and its unions the ability to reduce retiree health costs within FEHBP</u>. NALC and its members are willing to do our part to reduce the cost of future retiree health benefits at the bargaining table if Congress treats the Postal Service, its employees and the mailers fairly on pension costs. The best way to reduce the pre-funding burden on the Postal Service is to reduce the cost of health insurance in general, and retiree health insurance in particular.

Generally, the OPM and the FEHBP program have done a relatively good job in controlling health care costs. Indeed, the federal government's health care costs are lower than those of other large employers in the private sector, and the FEHBP program has restrained health care inflation better than employer plans in the private sector. Nevertheless, there is more that could be done to reduce health care costs – which could reduce the cost of prefunding retiree health benefits.

The Postal Service has asked Congress to let it leave the FEHB Program and set up its own health care program. The postal unions, including the NALC, oppose leaving FEHBP. But most of the savings the USPS thinks it can achieve outside of FEHBP could be achieved inside of FEHBP – if the USPS and its unions were allowed to negotiate an exclusive set of FEHBP plans to be offered to postal employees and future postal retirees (current postal retirees should keep the plans they have). This 'postal FEHBP exchange' could work with OPM to implement health plan innovations to incentivize good health and require the use of single network providers for medical services, hospital care and prescription drugs in order to cut costs. In addition, the 'postal FEHBP exchange' could achieve improved integration with Medicare and seek permission from OPM to implement a private sector-style Employer Group Waiver Plan (EGWP) to bring down the cost of drugs. Lower retiree health costs would translate into lower pre-funding payments.

It is urgent that Congress take action to repeal or reform the pre-funding mandate. We cannot imagine any member of the Senate, regardless of party or ideology, who would accept such a mandate being applied to a single private sector employer in his or her state. Yet because it is applied to a federal agency, it is ignored. But the negative impact it has on the

Postal Service is hurting the entire postal industry. Of the eight million workers in our industry, just over a half-million work for the USPS. The vast majority of the workers in our industry work in private companies across the country. The pre-funding mandate is not just dragging the USPS down; it's weakening an entire industry that employs workers in every state of the union.

III. Six-day Last Mile Delivery is the Postal Service's Core Function

The Postmaster General announced February 6th that the USPS intends to go to Monday-through-Friday delivery of letter mail and Monday-through-Saturday delivery of packages in early August. In view of the mandate to deliver all mail six days a week (including Saturdays) enacted annually by Congress over the past 30 years, and since it remains in effect today, the Postmaster General's announcement should be seen for what it is: an arrogant attempt to pre-empt the authority of Congress to set postal policy. There is no need to debate legal loopholes; the announcement clearly violates the will of Congress and the PMG should be reprimanded for his arrogance. If the USPS Board of Governors is behind this outrageous maneuver, it should be reprimanded too. If the Board is not, it should remove Postmaster General Donahoe.

The core competence and core asset of the Postal Service as an enterprise is its unmatchable, six-days-per-week, last-mile delivery network. It is a strategic asset that must be protected to return the Postal Service to health. It should not be sacrificed to maintain the disastrous pre-funding policy introduced in 2006, or even the modified pre-funding policy that was proposed by S. 1789 in the last Congress. That bill was well-intentioned in that it would have preserved Saturday delivery for at least two more years and would have made the decision to end Saturday delivery contingent on the unprofitability of the Postal Service. But degrading the Postal Service's core asset makes no business sense.

Therefore, we urge the Committee to continue to mandate six-day delivery in the law – and remove the possibility that Congressional appropriators might inappropriately seek "unified budget" savings by eliminating the six-day requirement even though the USPS receives no taxpayer money – a mistake the Obama administration made when it proposed to end Saturday delivery in its proposal to the Super Committee created by the Budget Control Act of 2011, and which it repeated in the past two budgets.

The Postmaster General has put forth a number of flimsy arguments in support of his five-day mail delivery proposal, even as he has failed to be fully forthcoming on the job losses his plan will entail. I wish address these arguments and note our concerns about jobs next.

First, the PMG's claim that the proposal would save $2 billion annually is clearly false. The PRC found in 2011 that the Postal Service's original five-day delivery plan, which did not involve the delivery of any packages or prescription drugs, would save at most $1.7 billion, even though that figure dubiously assumed almost no loss of mail volume due to reduced service. In fact, one of the Postal Service's own consultants, Opinion Research Corporation (ORC), concluded that the combined impact of slower service standards from its network optimization plan (involving mail processing plants), post office closings and the end of Saturday delivery would reduce total mail volume by 7.7 percent and result in a loss of $5.3 billion in revenues, far exceeding the $3.3 billion in cost savings estimated by ORC. These findings, based on 2010 data, were not shared with the PRC during its review of the five-day plan or its review of the network optimization plan. When the findings were discovered in 2012, the Postal Service dubiously disavowed them as "flawed" – though ORC has never disavowed its work. See Attachment 5, which provides a summary estimate of the impact of the planned service cuts on mail volume and postage revenue. It was introduced as an exhibit in the PRC proceeding by the American Postal Workers Union.

The Postal Service's own market research shows at least a third of business mailers value Saturday delivery (see below), including the weekly newsmagazine and newspapers that absolutely depend on it each week. Cutting Saturday delivery will drive periodical and advertising mail away (direct marketers will switch to delivery with newspapers) and make things worse, not better. As the Dow Jones company reported last week, it has already started to move Saturday deliveries of *The Wall Street Journal* to other delivery companies in anticipation of the Postal Service's move to end Saturday delivery. *New York* magazine and *The Economist* magazine have done so as well. Indeed, the Association for Magazine Media has criticized the move to five-day delivery. And while the trade association for many advertising mailers has not taken a position on Saturday delivery, many individual companies like Valasis Inc. (one of the nation's largest direct mailers), Hallmark and e-Bay oppose the change. The savings the Postal Service claims would be overwhelmed by the loss of revenues. At a minimum, the Postal Service should submit its new five-day plan for review by the PRC before Congress decides this matter.

Second, the Postmaster General falsely claims that the move to five-day mail service will not slow the delivery of mail. That is preposterous. The PMG admits that mail in collection boxes won't be collected on Saturdays and that mail will not be sorted to delivery point sequence on Friday nights. By definition this will slow the mail for American mailers – collection box mail will be delayed a day and mail destined for P.O. Boxes not sorted on Friday nights won't be in those boxes on Saturdays. When there is a federal holiday, the mail will be delayed even further. Slower service will drive business away, reducing revenue and driving the Postal Service to make even more self-defeating service cuts.

Third, the Postmaster General claims the USPS's customers are supportive of this change, citing so-called market research. Specifically he says: "Market research shows that seven out of

10 Americans support five day delivery." Not only is that statement incomplete, it's grossly misleading. Public opinion polls are not market research – especially when the folks polled are given a choice between the elimination of Saturday delivery or higher postage rates or closed post offices, which nearly every poll conducted does. Moreover, polling the recipients of mail misses the point – the overwhelming majority of mail (90-95%) is generated by businesses for households (including business reply envelopes used by consumers to pay their bills). Although city carriers feel strongly that we serve the public, the vast majority of paying customers of the Postal Service are business mailers. Their views on Saturday delivery are critical – not public opinion.

A 2009 survey of 4,100 businesses conducted by the USPS and the Mailers technical Advisory Committee (NMTAC) found that 32% of them opposed the shift to five-day. Another 2009 survey of 1,144 small businesses (less than 250 employees) for the USPS by the Maritz Company found that 68% supported the plan – meaning that up to 32% didn't. There are more than 25 million businesses of all sizes in the United States. If a third of these businesses oppose the plan, as the Postal Service's own surveys show, then literally millions of businesses will suffer from the Postal Service's plan.

Members of the Committee should not blindly follow public opinion when it comes to Saturday delivery. Of course, in electoral terms, 7 out of 10 Americans is a landslide. But in business terms, failing to serve 3 out of every 10 customers is a prescription for bankruptcy. How can the Postal Service if they cut a service – Saturday delivery – millions of business customers need? And if a substantial number of those spurned business customers find alternatives or reduce their volume of mail, how can the majority of customers who claim to support the plan not face even further cutbacks and/or higher prices from the Postal Service? If that happens, 10 out of 10 Americans would be hurt and 100% of American businesses would suffer. The bottom line is clear: The Postmaster General's five-day plan is an anti-business plan that is not in the public's interest either.

Fourth, and most outrageously, the Postmaster General told reporters on February 6 that the employees of the Postal Service support his five-day delivery plan, basing it on the random conversations he has had with employees in post offices over the past year. Worse, he misleadingly implied that I personally accepted the plan and that "letter carriers" support his plan. This is pure nonsense and totally untrue. City letter carriers overwhelmingly oppose this plan. I know, I was elected to my job by them, and more than 90% of them voluntarily belong to NALC. Other postal employees feel the same way. All four postal employee unions issued statements on February 6th opposing the PMG's plan. Congress should not be swayed by the PMG's arrogant and misleading claim to speak for postal employees.

Fifth, the Postmaster General claimed that he listened to his customers and altered his original five-day plan to provide Saturday delivery of packages, including the delivery of prescription drugs. While we are heartened that the PMG would listen to his customers, we wonder why he won't listen to the millions of businesses who value Saturday mail and periodical delivery as well, and we are concerned that the PMG will risk our recent gains in package delivery market share by adopting his plan. The PMG proudly cites the 14% growth in package volume in recent years. And in the first quarter, the USPS reported a 19% growth in revenue from Parcel Return and Parcel Select, the services private delivery companies use to take advantage of the Postal Service's first- and last-mile capabilities. Indeed, in its press release announcing the first quarter results, the Postal Service cited the "comparative advantage" of its last mile delivery network as the driving force behind its strong growth in package delivery.

But that growth and that comparative advantage have been built on a shared, multi-product, last-mile delivery network. By delivering letters, flats, and parcels together, the cost of USPS package delivery has been kept quite low. How will the Postal Service remain the most affordable provider of package delivery to residential neighborhoods if it gives away this pricing advantage? Economists call this the economies of scope. Will the Postal Service's plan recklessly throw away these economies just when the e-commerce boom is gaining momentum? How much business will we lose from FedEx SmartPost and UPS SurePost by eliminating Saturday delivery? Will new competitors emerge to offer Saturday delivery service for newspapers, direct mail and flats that will cause even more volume loss? We believe the answers to these questions will make it very clear that the elimination of Saturday mail delivery makes no business sense.

Finally, on the Saturday delivery issue, the Postmaster General has not been entirely forthcoming with Congress or the public on the negative employment impact his plan will have on the U.S. economy. In his press conference, he said that the plan would eliminate 22,500 jobs. But his press materials make reference to 35,000 full-time equivalent jobs. Back in 2010, when the plan was first formulated, the Postal Service met individually with the four unions and provided the following estimates of job losses for the plan to cut Saturday mail delivery: 25,846 full-time city carriers, 53,240 full- and part-time rural carriers, 2,250 clerks and other employees in APWU crafts, and 450 mail handlers for a total of 81,786 full- and part-time jobs. As we saw with the suppressed evidence during the PRC proceeding on network optimization, the Postal Service doesn't really know how much, if any, savings will result from all their service cuts. Based on the constantly shifting numbers on jobs, it doesn't seem to know how many jobs are at stake with its proposed elimination of Saturday mail delivery. The Postal Service is not being straight with the Congress or the public. This must change.

IV. Pricing and products reform

In the absence of the pre-funding mandate, the introduction of a streamlined system of rate regulation would have made a lot of sense in 2006. Replacing the costly and time-consuming system of setting postage rates through months of expensive litigation between competing sets of mailers was a laudable goal. Unfortunately, the Congress saddled the Postal Service with a huge new mandate at the same time it implemented the price cap on its rates. The cost of the pre-funding mandate was never built into the Postal Service's prices because the USPS did not conduct the one-time, final omnibus rate case called for in the PAEA. (The USPS rightly did not want to raise rates in the midst of the recession.) Even without the crushing burden of pre-funding, the cost of mail delivery on a unit basis was bound to rise as Internet diversion reduced mail volume, but the Postal Service cannot charge mailers the true cost of delivering the mail. This pricing regime is not sustainable and is contributing to the mindless downsizing that threatens to destroy a key part of the nation's economic infrastructure.

At a minimum, the Postal Service should be given the right to adjust its rates with a one-time proceeding before the Postal Regulatory Commission. The omnibus postage rate review and adjustment that was authorized by the PAEA, but that did not happen in 2007, should be conducted in 2013. If Congress insists on the prefunding mandate, then it is only fair that at least some of its cost should be built into the postage rates the Postal Service charges its customers. Such a one-time rate is needed to provide reasonable balance to the huge sacrifices postal employees have made in recent years.

But in addition, the Postal Service must be able to generate greater revenues to balance the cost-cutting it will continue to pursue. No struggling enterprise can mindlessly downsize its way back to health. It must have a growth strategy and be able to generate new revenues. There are three ways that the Postal Service can increase revenue: grow the existing business in sectors of the mailing industry that are expanding (package delivery, returns and e-commerce), better align prices to reflect costs (pricing reform), and find new uses of the Postal Service's networks that can help finance and preserve the valuable last mile delivery networks that the country depends on for commerce, communication and voting. The USPS is already doing the first and will continue to succeed so long as it does not destroy its own comparative advantage by degrading its last-mile network. But Congress must enact reforms to help USPS increase revenues in the second and third ways.

First, on pricing reform, the case can be made to eliminate the price cap altogether, as the regulator in Great Britain has done recently. Postal operators no longer have the ability to abuse their monopolies – there is an electronic or physical alternative to every service they provide. The USPS has no market power whatsoever – if it raises rates too high, customers will leave the mail system. There is market discipline in place. On the other hand, mailers legitimately want some protection against capricious rate increases. But the USPS needs greater flexibility to set rates that will cover its costs.

The reforms proposed by S. 1789 are a good start, but the price index system for market-dominant products must be updated and must be based on an appropriate benchmark index. The Consumer Price Index for All-Items is not the correct index. The Postal Service is part of the national delivery industry, a transport-based, energy-intensive industry that has unique characteristics. Although the USPS is by definition more labor-intensive than private companies like FedEx and UPS – we deliver to 150 million addresses six days a week, not 15 million addresses five days a week – the USPS faces the same cost pressures as those companies. At a time of soaring energy costs, the rates charged by private companies that provide delivery services have increased at more than twice the rate of postage -- see Table 2 above. If the USPS is to preserve its networks, it must be given pricing flexibility. Congress should modernize the price indexing system and replace the CPI-All Items with the CPI for Delivery Services. It is the appropriate private sector benchmark and it will help with the budget scoring on the legislation.

Second, on products, the overly restrictive definition of a postal product contained in the PAEA should be liberalized. Again, the reforms in S.1789 show the way. Opening the mail to beer and wine sales makes sense. But the range of services the Postal Service could provide is much greater and it should be given the right to find new uses for its networks. Whether its meter reading for utility companies as an alternative to expensive smart meters, or partnerships with private banks to serve Americans in rural and depressed urban areas where commercial banks have no presence, or recycling computer parts in partnership with private companies, the Postal Service needs greater commercial freedom. We believe an innovation commission as proposed by Senator Sanders makes great sense. That commission should study the possibility of using the nation's post office network as the backbone of a National Infrastructure Bank, and Congress should consider giving every American the right to vote by mail in federal elections. A more entrepreneurial Postal Service could do what the Post Office has done since it was mandated by the Constitution – evolve to meet the changing needs of the country. But to achieve a more entrepreneurial culture, the governance structure of the Postal Service needs to be reformed. I will turn to this topic next.

V. Governance reform

At a moment when the Postal Service faces the gravest crisis in its history, its Board of Governors might soon be known as a Board of Vacancies. The Board of Governors is made up of nine presidential appointees, plus the Postmaster General and the Deputy Postmaster General. At the moment, four of the nine appointed seats are vacant and one governor is in his one-year hold-over period following the expiration of his term. The gridlock that has hampered the appointment process in general has really damaged the Postal Service in particular. When you consider that the terms of two of the five commissioners on the Postal Regulatory Commission have also expired, the appointments problem is even deeper. But what truly makes the problem a crisis is that the PAEA's guidelines for appointments to the Board have not been followed.

The PAEA amended the law to require that "at least 4 of the Governors shall be chosen solely on the basis of their demonstrated ability in managing organizations (in either the private or the public sector) that employ at least 50,000 employees. Although all of the governors who serve are honorable people, none of them meet this requirement. As our advisers at Lazard reported to us, the Postal Service lacks a Board with the kind of business experience needed to create a vision for a revitalized Postal Service – nor does it have the kind of executive talent needed to execute such a vision. Instead, the Board has approved the "shrink to survive' strategy that Lazard believes is doomed to fail.

NALC calls on Congress to overhaul the governance structure of the Postal Service to give it the best chance for a turnaround. NALC will work with any leadership team that develops a strategy for growth and is dedicated to the long-term viability of the Postal Service.

VI. Addressing the Cash Crisis: Return of the FERS Pension Surplus

The reforms we have advocated in this testimony are essential to the survival of the Postal Service well into the 21st Century. But we also face a short-term solvency crisis. The prefunding mandate, the Great Recession, and the misguided business plan of current postal management have left the Postal Service desperately short of cash. In order to prevent an economically damaging interruption of service and to give the reforms outlined below the time they need to work, Congress must also restore the liquidity the Postal Service needs to operate. Fortunately, there is a surplus in the Postal Service's FERS pension account that nobody disputes. Due to falling discount rates, that surplus declined from $11.4 billion in 2011 to $3.0 billion in 2012. But if returned to the Postal Service, it is still enough to pay down its debt and maintain operations as it implements other reforms to restore its viability. Congress should change the law to allow for this transfer from the FERS postal account in the CSRDF to the Postal Service.

Note, however, that the actual surplus in the postal FERS account would be much larger if measured properly, according to a recent report from USPS Office of Inspector General prepared by The Hay Group. The report, entitled *Causes of the Postal Service FERS Surplus* (Report Number: RARC-WP-13-001, October 12, 2012), found that if the OPM were to use USPS-specific economic, demographic and mortality assumptions in its annual valuation of the FERS postal sub-account within the Civil Service Retirement and Disability Fund, the actual surplus would have been $24.0 billion in 2011. A subsequent update to the report released on December 4, 2012 (RARC-WP-13-002) incorporated the OPM's lower interest rate assumptions for 2012 – and therefore reduced the OIG's estimated surplus to $12.5 billion.

The use of USPS-specific assumptions increases the measured FERS surplus because the Postal Service's work force is different than the rest of the federal workforce; its employees are a distinct group with markedly different demographic and mortality characteristics. Historically, salary increases in the Postal Service have lagged those in the federal government overall and life expectancy among mainly blue collar postal employees is less than it is, on average, for mainly white collar federal employees. A fair valuation of the postal sub-accounts requires the use of USPS-specific assumptions.

The legislation drafted by the Committee should direct the OPM to use accurate, postal-specific assumptions and the resulting FERS surplus of $12.5 billion should be used to stabilize the Postal Service's finances as other reforms are put in place. A transfer of the FERS postal surplus would set the stage for a major turnaround at the Postal Service, provided that the reforms outlined above are enacted and the Congress prevents current postal management from driving America's Postal Service into a death spiral.

VII. Conclusion

It is our sincere hope that this Committee will hold other hearings on the issues we have raised in our testimony before you draft legislation. We would welcome the chance to have the voices of the Postal Service's largest group of craft employees heard and I would personally welcome the chance to have a dialogue with all of you about the future of the Postal Service. I would be happy to answer any questions you have at that time. NALC is committed to working together with both parties to fashion a bi-partisan reform bill that will preserve a strong and vibrant Postal Service for decades to come. Thank you for considering our views.