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STATEMENT OF
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BEFORE THE
SUBCOMMITTEE ON POSTAL OPERATIONS AND SERVICES
SUBCOMITTEE ON POSTAL PERSONNEL AND MODERNIZATION
COMMITTEE ON POST OFFICE AND CIVIL SERVICE
HOUSE OF REPRESENTATIVES
ON
THE PRESENT STATE OF THE
UNITED STATES POSTAL SERVICE

Messrs. Chairmen and Members of the Subcommittees:

We are pleased to be here today to present our views on the events and issues that currently affect the operation and management of the Postal Service.

After three straight years of relatively stable and profitable operations, fiscal year 1985 has been a time of change and challenge for the Postal Service. Of special significance, this streak of profitable years was broken as the Service incurred a large and unexpected loss. Before commenting on this, I would like to briefly discuss some of the important events which occurred during the past 9 months or so.

To start, the people holding many senior managerial positions have changed since January. A new Postmaster General and Deputy were appointed and leadership changed in at least 16 other executive positions, including 4 of the 5 Senior Assistant Postmaster General positions. Most of these changes were announced in February and were made within a few months.

In December and January, 5 to 6 months after contracts expired, the Service and the unions representing most postal employees entered into new labor contracts which increased wages. The contracts were produced by arbitration rather than negotiation. Three other cost increasing events occurred in January--the transportation of mail by air carriers became deregulated, the decision to give preferential treatment (same as First-Class Mail) to second-class mail was fully implemented, and a decision was made to improve deteriorating mail service.

In February, new postage rates, the first in over 3 years, went into effect and the price of a First-Class stamp went from 20 cents to 22 cents. However, these increases, on average, were less than the Service requested. Overall, the Service had proposed a 15 percent average rate increase but received 9 percent.

In July, the Service's Board of Governors announced a major mid-course change in the ZIP + 4 program, the Service's long-term and widely debated automation program for reducing mail processing costs. The change concerns the use of multiline optical character readers, or OCRs, to automate mail processing operations. We understand that the Service plans to buy up to 250 multiline OCRs and to convert to multiline technology the 403 single-line OCRs purchased in 1984.

In August, the Service announced plans to seek--later this fall--an increase in the postage discount large-volume mailers receive for using ZIP + 4 codes. The expanded ZIP Code is a critical part of the automation program and mailers have not used the code anywhere near the levels the Service originally envisioned. This decision signals that the Service remains committed to having large-volume mailers use the ZIP + 4 code but is preparing for low usage by acquiring multiline read OCRs. The multiline OCR needs no ZIP Code on the mail piece if the address is in the machine's internal directory but operates more efficiently when a ZIP Code is present.

In September, the Board of Governors approved the borrowing of up to $1 billion to finance capital investments and thereby replenish working capital, which has been used in lieu of borrowing to finance capital investments in recent years. The last borrowing occurred in 1976.

During the past several months, Postmaster General Carlin and his managers were confronted with a very difficult and unexpected challenge: how to avoid a potential $500 million deficit for postal fiscal year 1985, which ended just last week. In contrast, the budget for 1985 anticipated net income of $56 million. Mr. Chairman, I know that you and the members of these subcommittees have been deeply concerned about the potential deficit and, in your hearings this past summer, encouraged Service officials to take definitive and reasonable measures to prevent it.

NET LOSS FOR POSTAL FISCAL YEAR 1985

Although the Service has cut expenses to below budget for recent months, postal fiscal year 1985 undoubtedly ended with a deficit. The final numbers for 1985 are not yet available but we estimate the deficit to be around $270 million. We base our statement on the financial trends that occurred in the first 11 months of the fiscal year and the extension of those trends through the final month.

A $326 million "miss"--our estimated $270 million deficit plus the Service's planned net income of $56 million--is less than 2 percent of the almost $29 billion 1985 budget. Even so, a $270 million loss is worrisome for several reasons. Not the least among them is whether the causes of the deficit will carry over to succeeding years and lead to rate increases much sooner than expected.

1985 Revenue

Comparing the Service's revenue and expenses in 1985 to amounts budgeted, the causes of the deficit come more from the expense side than the revenue side. Overall revenue for 1985, we believe, will closely approximate the budgeted amount--$28,886,445,000.

The Service earns most of its revenue from delivering mail, and the volume of mail delivered in 1985 was probably slightly lower--less than 1 percent--than what the Service estimated. However, even at this laudable degree of estimating precision, the difference is worth about $114 million. This revenue shortfall--caused by lower-than-planned mail volume--was made up by other revenue sources and circumstances.

For example, the new postage rates took effect about one month earlier than the Service planned in its budget. We estimate the new rates produced additional revenue of nearly $170 million during that month. (The new rates would have produced additional revenue approximating $900 million if they had taken effect at the start of the fiscal year.)

The increased rates were not effective during the Christmas season--the most profitable months for the Service. Furthermore, for the 4 week accounting period ending January 18, 1985, the Service incurred a very substantial loss--$202 million--almost 75 percent of our estimated net loss for the year. In hindsight, the financial picture for 1985 would have had less or maybe no "red ink" if the new rates could have been made effective earlier in the year.

1985 Expenses

The 1985 deficit was caused mostly by larger-than-planned expenses, principally for salaries and benefits and domestic transportation. The Service is a labor-intensive organization and salaries and benefits naturally constitute the largest portion of its operating costs. In 1985, that portion was around 83 percent. Domestic transportation involves the use of trains, trucks, airplanes, and water vessels to move mail from one location to another. It is the Service's second largest operating expense.

Salaries and benefits

Through August 30 of fiscal year 1985, the cost of salaries and benefits was about $441 million over budget, largely for two reasons.

--About $170 million awarded to postal employees by the labor settlement was not budgeted. The arbitrators' awards were larger than the amounts the Service estimated when preparing the budget.

--Nearly 22 million more workhours than planned were used to operate the Service. Workhour usage has been spurred by a higher processing priority for second-class mail and a decision to reverse a deterioration in mail service.

Regarding mail service, the Service has 1-day (overnight), 2-day, and 3-day delivery standards for First-Class Mail. The distance a letter travels determines the applicable standard; for example, across town is 1 day and across the country is 3 days. The Service gauges its performance by comparing the current year's performance with that of the previous year. During fiscal year 1985, mail service to 1-day areas has been at or better than 1984 levels. However, for much of fiscal year 1985, mail service to 2- and 3-day areas has either been below 1984 levels for weeks at a stretch or been inconsistent, fluctuating above, at, and below 1984 levels. For the 4 weeks ending August 30, service to 2- and 3-day areas was at or above 1984 levels.

Domestic transportation

Domestic transportation is over budget primarily due to air transportation costs. These costs were the subject of a hearing this past summer by the Subcommittee on Postal Operations and Services. As of August 30, air transportation costs were nearly $109 million (about 20 percent) over budget.

FISCAL YEAR 1986 OUTLOOK

Now that fiscal year 1985 is over, the question is whether the financial picture for 1986 will resemble 1985. We have no precise prediction to offer but we would like to point out several conditions affecting the 1986 budget and, using a number of assumptions, indicate where the year could end financially.

Last month, the Deputy Postmaster General told the Board of Governors that Regional Postmasters General and Headquarters' officials would submit "break even" budgets for 1986. The break-even budgets were developed after the Service had projected a deficit as large as $588 million for 1986.

"Revenue Forgone" Appropriation

One item which could critically affect the Service's 1986 financial picture is the revenue forgone appropriation. The appropriation reimburses the Service for overhead costs assigned to special categories of mail, such as third-class letters sent by nonprofit organizations and educational material sent to or by schools.

The Office of Management and Budget, the agency that makes the revenue forgone appropriation request for the Service, refused to request funds for 1986. However, Congress has signaled that it will appropriate funds. It passed a budget resolution that provides $749 million, a sum large enough to cover all assigned overhead costs. Larger amounts--to also lower the direct costs mailers pay--have been recommended by the appropriation committees.

To date, a revenue forgone appropriation for the year remains unauthorized. The Service will have to bear all the overhead costs if no appropriation is provided or bear the cost for any amount appropriated less than $749 million. We doubt that postage rates could be adjusted in 1986 to recover overhead costs.

Clearly the Service must continue to seek ways to contain operating costs because factors which contributed to 1985 increases will not disappear. The overall number of paid employees is not expected to decline appreciably, although the number may level off. Wage increases required by the new labor contracts must be funded and the current contracts for air transportation services remain in effect. On the plus side, the new management team should be firmly in place and the 1985 rate increases will cover a full year. Assuming a 6 percent increase in mail volume, the same as occurred in 1985, and no unexpected major cost increases, we believe that although 1986 will probably also be a deficit year, the amount could be less than that experienced in 1985.

That concludes my statement, Mr. Chairman. We will be happy to answer any questions you may have.