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Report to Congressional Committees

April 2010

U.S. POSTAL SERVICE

Strategies and Options to Facilitate Progress toward Financial Viability

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GAO-10-455

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Highlights

Highlights of GAO-10-455, a report to congressional committees

April 2010

U.S. POSTAL SERVICE

Strategies and Options to Facilitate Progress toward Financial Viability

Why GAO Did This Study

The Postal Accountability and Enhancement Act of 2006 required GAO to evaluate strategies and options for reforms of the United States Postal Service (USPS). USPS's business model is to fulfill its mission through self-supporting, businesslike operations; however, USPS has experienced increasing difficulties. Due to volume declines, losses, a cash shortage, and rising debt, GAO added USPS's financial condition to its high-risk list in July 2009.

GAO's objectives were to assess (1) the viability of USPS's business model, (2) strategies and options to address challenges to its business model, and (3) actions Congress and USPS need to take to facilitate progress toward financial viability. GAO primarily drew on its past work; other studies; USPS data; interviews with USPS, unions, management associations, Postal Regulatory Commission, and mailing industry officials; and stakeholder input.

What GAO Recommends

Congress should consider providing financial relief, such as revising USPS retiree health benefit funding and requiring any binding arbitration to take USPS's financial condition into account. At the same time, Congress should consider setting up a panel of experts to develop proposals for broader legislative and operational reform. USPS agreed with the report's key findings but raised concerns about a panel and its timing. Such panels have successfully informed prior difficult restructuring decisions.

View GAO-10-455 or key components.
For more information, contact Phillip Herr at (202) 512-2834 or herrp@gao.gov.

What GAO Found

USPS's business model is not viable due to USPS's inability to reduce costs sufficiently in response to continuing mail volume and revenue declines. Mail volume declined 36 billion pieces (17 percent) over the last 3 fiscal years (2007 through 2009) with the recession accelerating shifts to electronic communications and payments. USPS lost nearly $12 billion over this period, despite achieving billions in cost savings by reducing its career workforce by over 84,000 employees, reducing capital investments, and raising rates. However, USPS had difficulty in eliminating costly excess capacity, and its revenue initiatives have had limited results. USPS also is nearing its $15 billion borrowing limit with the U.S. Treasury and has unfunded pension and retiree health obligations and other liabilities of about $90 billion. In 2009, Congress reduced USPS's retiree health benefit payment by $4 billion to address a looming cash shortfall, but USPS still recorded a loss of $3.8 billion. Given its financial problems and outlook, USPS cannot support its current level of service and operations. USPS projects that volume will decline by about 27 billion pieces over the next decade, while revenues will stagnate; costs will rise; and, without major changes, cumulative losses could exceed $238 billion.

This report groups strategies and options that can be taken to address challenges in USPS's business model by better aligning costs with revenues (see table on next page). USPS may be able to improve its financial viability if it takes more aggressive action to reduce costs, particularly compensation and benefit costs that comprise 80 percent of its total costs, as well as increasing revenues within its current authority. However, it is unlikely that such changes would fully resolve USPS's financial problems, unless Congress also takes actions to address constraints and legal restrictions.

Action by Congress and USPS is urgently needed to (1) reach agreement on actions to achieve USPS's financial viability, (2) provide financial relief through deferral of costs by revising USPS retiree health benefit funding while continuing to fund these benefits over time to the extent that USPS's finances permit, and (3) require that any binding arbitration resulting from collective bargaining would take USPS's financial condition into account. Congress may also want assurance that any financial relief it provides is met with aggressive actions by USPS to reduce its costs and increase revenues, and that USPS is making progress toward addressing its financial problems. USPS's new business plan recognizes immediate actions are needed, but USPS has made limited progress on some options, such as closing facilities. If no action is taken, risks of larger USPS losses, rate increases, and taxpayer subsidies will increase. To facilitate progress in these difficult areas, Congress could set up a mechanism, such as one similar to the military Base Realignment and Closure Commission, where independent experts could recommend a package of actions with time frames. Key issues also need to be addressed related to what changes, if any, should be made to delivery or retail services; to allow USPS to provide new products or services in nonpostal areas; and to realign USPS operations, networks, and workforce.

Highlights of GAO-10-455 (continued)

The table below summarizes selected strategies and options for action by Congress and USPS to address USPS's financial viability, with some options requiring collaboration with unions through collective bargaining.

Challenges	Options for USPS	Options for Congress
Strategy: Reduce compensation and benefits costs		
Workforce size: • About 300,000 postal employees are expected to retire through 2020. • Collective bargaining agreements include limits on outsourcing. • Postal unions are concerned about the loss of jobs paying a middle-class wage and benefits to private-sector jobs with lower wages and no benefit guarantees.	Reduce the size of the workforce through retirements and outsourcing, where it is cost-effective to do so.	
Wages: USPS is required to maintain compensation and benefits comparable to the private sector, and wages account for about one-half of USPS's costs.	Reduce wage costs, for example, through a two-tiered pay system that would pay new hires lower wages and "grandfather" employees in the current system.	Require arbitrators to consider USPS's financial condition when making binding arbitration decisions.
Benefits: • USPS benefits account for over 23 percent of USPS's costs. USPS is required to make annual multibillion dollar retiree health benefit payments. • Employees eligible for workers' compensation benefits can continue these more generous benefits even when eligible to retire.	Reduce benefit costs by reducing USPS health and life insurance contribution rates for active employees to levels comparable to those paid by other federal agencies.	• Defer costs by revising funding requirements for retiree health benefits. • Revise workers' compensation laws for employees eligible for retirement.
Workforce mix and work rules: USPS has a high ratio of full-time career employees—about 78 percent—and wants flexibility to hire more part-time employees.	Adjust workforce mix, for example, by using more part-time staff.	
Strategy: Reduce other operations and network costs and improve efficiency		
• USPS has costly excess capacity and inadequate flexibility to quickly reduce costs in its retail, processing, and delivery networks. • Closing facilities has been limited by political, employee, union, and community opposition to potential job losses. • *Retail:* Legal restrictions limit its ability to close certain types of post offices. • *Delivery:* Delivery is the largest cost segment, labor-intensive, and required by statute to be provided 6 days a week.	*Mail processing:* • Close unneeded facilities. • Relax delivery standards to facilitate closures and consolidations. *Retail:* • Optimize USPS retail facility network (including hours and locations). • Move more retail services to private stores and self-service and close unneeded retail facilities. *Delivery:* Expand use of more cost-efficient delivery, such as cluster boxes. *Field structure:* Reduce the number of field administrative offices.	*Mail processing:* Support having USPS reduce excess capacity by closing some of its major mail processing facilities. *Retail:* Remove statutory and appropriations language restricting USPS's ability to close some of its 36,500 retail facilities. *Delivery:* Remove appropriations language requiring 6-day delivery.
Strategy: Generate revenues through product and pricing flexibility		
• The changing use of the mail is projected to continue limiting USPS's ability to generate sufficient revenues. • Rate increases for market-dominant products are limited by the inflation-based price cap. • Large rate increases may lower USPS revenues in the long run and add to its excess capacity. • In fiscal year 2009, USPS lost $1.7 billion from products with revenues that did not cover costs, mainly Periodicals and Standard Mail Flats (e.g., catalogs).	• Revise pricing for market-dominant products, such as First-Class Mail and Standard Mail. • Address loss-making products by better aligning prices and costs. • Provide volume incentives for certain types of bulk business mail. • Develop new postal products and product enhancements. • Provide incentives by simplifying complex rules for mail preparation.	Determine whether preferential pricing required by law for loss-making products should continue.

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Figures

Abbreviations

AMP	Area Mail Processing
BRAC	Base Realignment and Closure
CBO	Congressional Budget Office
CSRDF	Civil Service Retirement and Disability Fund
CSRS	Civil Service Retirement System
Dual CSRS	Dual Civil Service Retirement System and Social Security
FEHB Fund	Federal Employees Health Benefits Fund
FERS	Federal Employees Retirement System
FTC	Federal Trade Commission
NSA	negotiated service agreement
OIG	Office of Inspector General
OPM	Office of Personnel Management
PAEA	Postal Accountability and Enhancement Act of 2006
PRA	Postal Reorganization Act of 1970
PRC	Postal Regulatory Commission
RHB Fund	Postal Service Retiree Health Benefits Fund
TSP	Thrift Savings Plan
UPS	United Parcel Service
USPS	United States Postal Service

United States Government Accountability Office
Washington, DC 20548

April 12, 2010

Congressional Committees

The Postal Accountability and Enhancement Act[1] (PAEA) of 2006 required GAO to evaluate strategies and options for the long-term structural and operational reform of the United States Postal Service (USPS). At that time, USPS was given additional pricing flexibility and required to develop service standards, while PAEA reconfigured certain financial obligations. These changes provided additional tools to improve its effectiveness and accountability in an increasingly competitive delivery and communications marketplace. Recent developments have highlighted deficiencies in USPS's business model, which is to fulfill its mission through self-supporting, businesslike operations. As mail volume declined in fiscal years 2007 through 2009, USPS financial viability deteriorated, and it was not able to cut costs fast enough to offset the accelerated decline in mail volume and revenue. These volume declines have been brought on by customers' changing use of the mail and have been accelerated by the recession and continuing difficulties in the economy. In fiscal year 2009, total mail volume declined by a record 26 billion pieces, while revenue dropped nearly $7 billion. USPS has incurred close to $12 billion in losses in fiscal years 2007 through 2009 and is rapidly approaching its statutory debt limit. Furthermore, a looming cash shortfall at the end of fiscal year 2009 necessitated last-minute congressional action that deferred costs by reducing USPS's mandated retiree health benefit payments. On the basis of these challenges, in July 2009, we testified[2] that a restructuring of USPS was needed to enhance its current and long-term financial viability and placed USPS's financial condition on our high-risk list.[3]

USPS's financial outlook is poor. In fiscal year 2010, USPS expects a record loss of over $7 billion, its outstanding debt to increase to $13.2 billion, and limited cash flow that will continue to constrain capital investment. USPS projections show losses growing over the next decade

[1]Pub. L. No. 109-435, 120 Stat. 3198 (Dec. 20, 2006).

[2]GAO, *U.S. Postal Service: Broad Restructuring Needed to Address Deteriorating Finances*, GAO-09-790T (Washington, D.C.: July 30, 2009).

[3]GAO, *High-Risk Series: Restructuring the U.S. Postal Service to Achieve Sustainable Financial Viability*, GAO-09-937SP (Washington, D.C.: July 28, 2009). USPS's transformation efforts and long-term outlook were on our high-risk list from 2001 to 2007.

as mail volume declines further and costs rise. USPS remains the largest civilian federal agency (employing about 712,000 employees at the end of fiscal year 2009), has a nationwide network of about 38,000 facilities, and provides 6-day-per-week mail delivery to most of the nation's 150 million addresses.

PAEA required that GAO complete this report by December 2011. Because of USPS's financial crisis and our assessment that restructuring is urgently needed, our work has been accelerated at the request of Members of Congress and is presented in this report. Our objectives were to assess (1) the viability of USPS's business model, (2) strategies and options to address the challenges to USPS's current business model, and (3) actions Congress and USPS need to take to facilitate progress toward USPS's financial viability.

In conducting our work related to assessing the viability of USPS's business model and strategies and options to solve its challenges, we relied on our past work and USPS financial and operating data. We interviewed various USPS officials, including the Postmaster General, the Deputy Postmaster General, the former and current Chairmen of the Board of Governors, and headquarters and field staff. We reviewed USPS's *Action Plan* released March 2010 and its financial and volume projections.[4] We did not assess the validity of USPS's financial and mail volume projections due to time and resource constraints. We reviewed USPS's current legal and regulatory framework and relevant congressional testimonies and hearings. We also reviewed the results of retiree health valuations provided to us by the Office of Personnel Management (OPM) in March 2010, which were based on USPS employee population projections. We did not assess the reasonableness of these projections or OPM's actuarial assumptions and methodology. We utilized OPM's valuation results to analyze the financial impacts of selected options for funding USPS's retiree health benefit obligations.

We also examined studies performed by other postal stakeholders, including the Postal Regulatory Commission (PRC), USPS Office of Inspector General (OIG), the 2003 President's Commission on the United States Postal Service, and other mailing industry experts. We met with

[4]United States Postal Service, *Ensuring a Viable Postal Service for America: An Action Plan for the Future* (Washington, D.C.: March 2010). USPS's plan and related material are available at the following Web address: http://www.usps.com/strategicplanning/futurepostalservice.htm (accessed on Apr. 9, 2010).

PRC commissioners and staff, representatives of the four major employee unions and three major management associations, USPS OIG, members of the mailing industry, economists, and other stakeholders. We distributed a list of questions to over 60 organizations to collect additional information on actions that could be taken to improve USPS's business model and the potential impacts of these actions. The organizations represented various sections of the postal community, such as postal unions and management associations; small and large mailers; and mailers across various segments (e.g., First-Class Mail, Standard Mail, Periodicals, parcels, newspapers, and nonprofit mail); and other companies in the mailing industry. They were selected on the basis of several factors, including testifying before Congress on postal issues; submitting comments to the 2003 President's Commission; submitting comments to PRC on universal service, the postal monopoly, and the new regulatory structure for ratemaking; and submitting comments to the Federal Trade Commission (FTC) on differences in the legal status between USPS and its competitors.

We gathered and evaluated relevant strategies and options on the basis of a variety of criteria, including their potential to reduce USPS costs, realign its operations, and increase revenues, in light of USPS's current and projected financial condition. In this report, we present selected options that could be considered to address USPS's financial viability on the basis of these criteria. Some options are consistent with actions we have discussed in our past work, while others have been discussed in congressional hearings, regulatory proceedings, and major studies. We analyzed the options on the basis of the criteria that we have previously listed, including available cost and revenue data. Furthermore, assessing certain options related to a comprehensive restructuring of USPS's legal and regulatory framework was limited because it is still too soon to see the full impact of the changes from PAEA. We also plan to address the experiences of foreign postal administrations in a separate report.

We conducted this performance audit from August 2009 to April 2010 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Appendix I contains a detailed discussion of our scope and methodology. We requested comments on a draft of this report from USPS, and its comments are discussed later in this report and reproduced in appendix II.

Background

Over the last 40 years, Congress has considered several business models to provide postal services to the nation and moved USPS toward a more businesslike entity but has simultaneously placed constraints on its operations. Until 1970, the federal government provided postal services via the U.S. Post Office Department, a government agency that received annual appropriations from Congress. Congress was involved in many aspects of the department's operations, including the selection of managers (e.g., postmasters), and in setting postal rates and wages. A presidential commission (The Kappel Commission) reported to the President in 1968 on the crisis facing the department, which included financial losses, management problems, service breakdowns, low productivity, and low employee morale. The Kappel Commission's basic finding was that "the procedures for administering the ordinary executive departments of Government are inappropriate for the Post Office."[5] Furthermore, it concluded that

> "a transfer of the postal system to the private sector is not feasible, largely for reasons of financing…but the possibility remains of private ownership at some future time, if such a transfer were then considered to be feasible and in the public interest…. We recommend, therefore, that Congress charter a Government-owned Corporation to operate the postal service. The corporate form would permit much more successful operation of what has become a major business activity than is possible under present circumstances."

The Postal Reorganization Act (PRA) of 1970 replaced the department with the current USPS model—an independent establishment of the executive branch designed to be self-sustaining by covering its operating costs with revenues generated through the sales of postage and postal-related products and services. USPS receives no appropriations for purposes other than revenue forgone on free and reduced rate mail.[6]

In 1996, Congress again began considering the merits of postal reform and ultimately enacted PAEA in 2006. A number of factors encouraged reform, including financial challenges, such as growing cash-flow problems and

[5]President's Commission on Postal Organization, *Towards Postal Excellence* (Washington, D.C.: June 1968).

[6]USPS receives annual appropriations for revenue forgone in providing (1) free and reduced rate mail for the blind and (2) overseas voting materials for U.S. elections. Congress appropriated about $118 million to USPS for these purposes for fiscal year 2010.

debt. A second presidential commission examined USPS's future and issued a report in 2003 that recommended a number of actions to ensure the viability of postal services.[7] Additionally, the Postal Civil Service Retirement System Funding Reform Act of 2003 was enacted after OPM determined that USPS was overfunding its employees' pensions.[8] This law required the amounts achieved by reducing the previous pension contributions to be used toward USPS's debt to the U.S. Treasury and set aside any remaining amounts in an escrow account. Congress addressed how the escrowed funds should be used—along with many of USPS's other financial and operational challenges—in PAEA. Key requirements and flexibilities provided in PAEA are detailed in table 1.

Table 1: Selected Requirements and Flexibilities Provided to USPS in PAEA

Key areas	Description
Flexible pricing mechanisms	• Abolished the former process for setting prices that was often lengthy, costly, and litigious. Under the new structure, USPS has broad latitude to announce price changes that are reviewed by the newly created PRC and implemented in a streamlined process. • Allowed USPS to raise average rates for each class of market-dominant products,[a] such as First-Class Mail, Standard Mail, Periodicals, and Package Services, up to a defined annual price cap; exceed the price cap should extraordinary or exceptional circumstances arise; and use any unused pricing authority within 5 years. • Allowed USPS to raise prices for competitive products, such as Priority Mail or Express Mail, as long as each product's revenue covers the product's costs and the revenue from all competitive products covers what PRC determines to be an appropriate share of USPS's institutional costs (overhead costs).
Modern delivery performance standards	• Required establishing modern delivery performance standards for market-dominant products. These standards for on-time delivery of mail enable mailers to have realistic expectations for the number of days mail takes to be delivered, and to organize their activities accordingly.
Restriction on nonpostal products	• Restricted USPS from introducing new nonpostal products and services. • Required PRC to review each nonpostal service USPS already offered and determine whether it should continue based on (1) the public need for the service and (2) the ability of the private sector to meet the public need for the service.
Retiree health benefit payments	• Required the funds accumulated in escrow and annual payments to be made in fiscal years 2007 through 2016 to prefund retiree health obligations.
Ability to retain earnings	• Allowed USPS to retain any earnings.

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

[8]Pub. L. No. 108-18, 117 Stat. 624 (Apr. 23, 2003).

Key areas	Description
Plan for improving operational efficiency	• Required USPS to develop a plan that, among other things, included a strategy for rationalizing the postal facilities network and removing excess processing capacity and space from the network, as well as identifying the cost savings and other benefits associated with network rationalization.
Financial reporting	• Established new reporting and accounting requirements to enhance collection and reporting of information on rates and financial performance.

Source: GAO analysis of Pub. L. No. 109-435.

[a]Market-dominant products primarily include First-Class Mail (e.g., correspondence, bills, payments, statements, and advertising); Standard Mail (mainly, bulk advertising and direct mail solicitations); Periodicals (mainly, magazines and local newspapers); and some types of Package Services (primarily, single-piece Parcel Post, Media Mail, library mail, and bound printed matter).

PAEA also made changes to USPS's regulatory and oversight structure. In addition to responsibilities for reviewing pricing and nonpostal services described in table 1, the newly created PRC gained additional oversight responsibilities, including responsibility for making annual determinations of USPS compliance with applicable laws, developing accounting practices and procedures for USPS, reviewing the universal service obligation, and providing transparency through periodic reports. The USPS Board of Governors, which has responsibilities similar to a board of directors of a publicly held corporation, directs the exercise of the powers of USPS, directs and controls its expenditures, reviews its practices, conducts long-range planning, and sets policies on all postal matters.[9] PAEA added new qualifications and lengths of term for new board members.

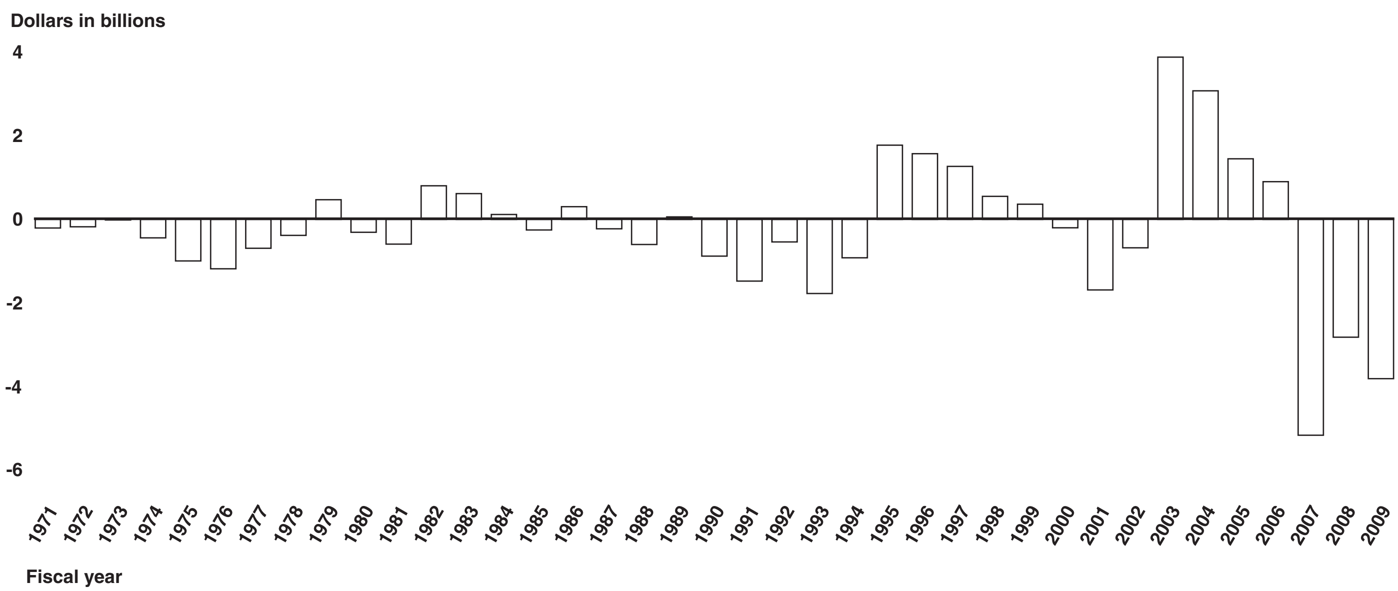
USPS's Business Model Is Not Viable

USPS's business model is not viable due to its inability to reduce costs sufficiently in response to continuing declines in mail volume and revenue. Mail volume declined 36 billion pieces over the last 3 fiscal years, 2007 through 2009, due to the economic downturn and changing use of the mail, with mail continuing to shift to electronic communications and payments. USPS lost nearly $12 billion over this period, despite achieving billions in cost savings, reducing capital investments, and raising rates. However, USPS had difficulty in eliminating costly excess capacity, and its revenue initiatives had limited results. To put these results into context, until recently, USPS's business model benefited from growth in mail volume to

[9]USPS is directed by a Board of Governors consisting of 11 members, including (1) 9 Governors appointed by the President, with the advice and consent of the Senate, to 7-year terms; (2) the Postmaster General, who is appointed by the Governors; and (3) the Deputy Postmaster General, who is appointed by the Governors and the Postmaster General. Not more than 5 of the 9 Governors may belong to the same political party.

help cover costs and enable it to be self-supporting. In each of the last 3 fiscal years, USPS borrowed the maximum $3 billion from the U.S. Treasury and incurred record financial losses (see fig. 1). A looming cash shortfall led to congressional action at the end of fiscal year 2009 that deferred costs by reducing USPS's mandated retiree health benefit payment. Looking forward, USPS projects continued mail volume decline and financial losses over the next decade.

Figure 1: USPS Annual Net Income (Loss), Fiscal Years 1971 through 2009



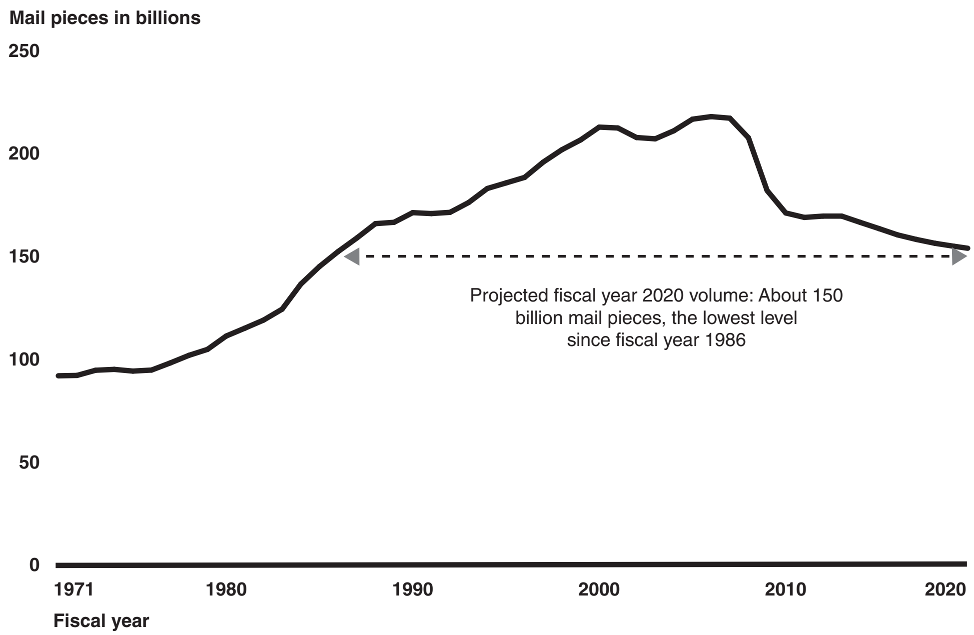
Source: USPS.

Note: A looming cash shortfall in 2009 necessitated last-minute congressional action to defer costs by reducing USPS's mandated payments to prefund retiree health benefits from $5.4 billion to $1.4 billion. While this action provided USPS with $4 billion of financial relief, USPS still reported a loss of $3.8 billion for the year. USPS's $8.4 billion in cumulative net income for fiscal years 2003 through 2005 largely resulted from a 2003 law (Pub. L. No. 108-18) that reduced USPS pension benefit payments by about $9 billion over this period.

USPS Faces Reduced Mail Volume from Changes in Mail Use

In fiscal year 2009, USPS's mail volume declined to 17 percent below its peak of 213 billion pieces in fiscal year 2006. USPS projects that total mail volume will decline to 167 billion pieces in fiscal year 2010—the lowest level since fiscal year 1992 and 22 percent less than its fiscal year 2006 peak. USPS and many mailers who provided information for this study do not expect volume to return to its former levels when the economy recovers. By fiscal year 2020, USPS projects further volume declines of 15 percent to about 150 billion pieces, the lowest level since fiscal year 1986 (see fig. 2).

Figure 2: Actual and Projected Total Mail Volume, Fiscal Years 1971 through 2020



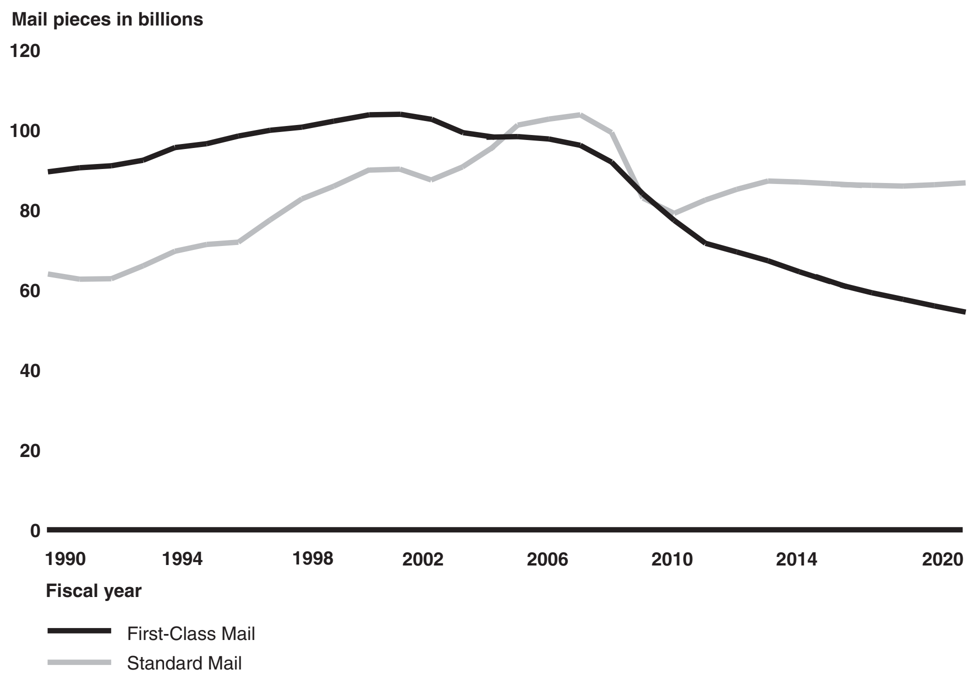
Source: USPS.

- First-Class Mail volume has declined 19 percent since it peaked in fiscal year 2001, and USPS projects that it will decline by another 37 percent over the next decade (see fig. 3). This mail is highly profitable and generates over 70 percent of the revenues used to cover USPS overhead costs.

- Standard Mail (primarily advertising) volume has declined 20 percent since it peaked in fiscal year 2007, and USPS projects that it will remain roughly flat over the next decade. This class of mail is profitable overall but lower priced, therefore, it takes 3.4 pieces of Standard Mail, on average, to equal the profit from the average piece of First-Class Mail.

Standard Mail volume was affected by large rate increases in 2007 for flat-sized mail, such as catalogs, and by the recession that affected advertising, such as mortgage, home equity, and credit card solicitations. These solicitations appear unlikely to return to former levels. Standard Mail also faces growing competition from electronic alternatives, increasing the possibility that its volume may decline in the long term.

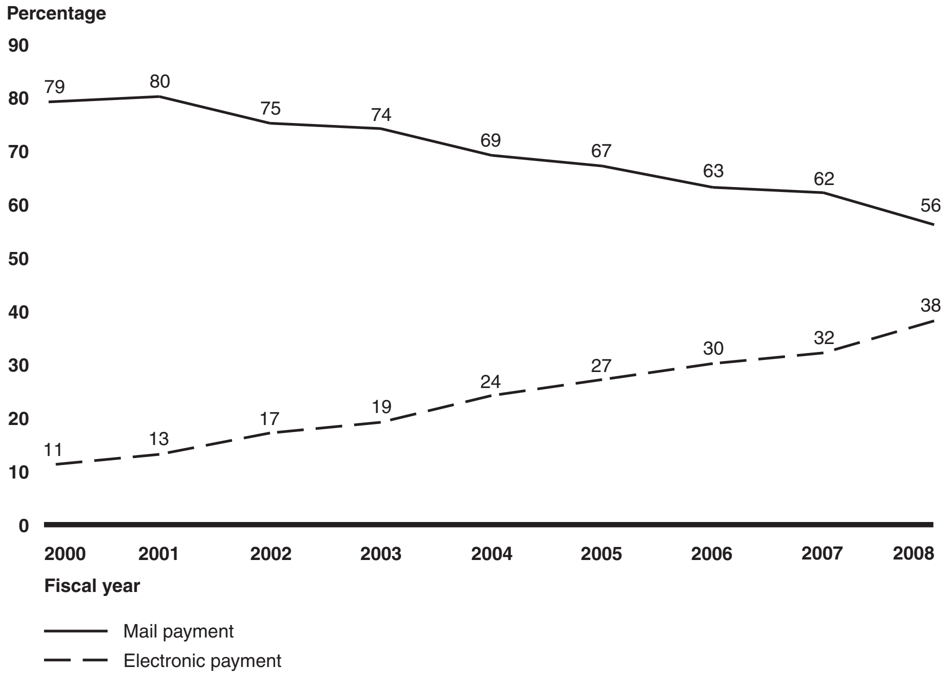
Figure 3: Actual and Projected First-Class Mail and Standard Mail Volume, Fiscal Years 1990 through 2020



Source: USPS.

One reason that mail volumes declined is because businesses and consumers have moved to electronic payment alternatives over the past decade (see fig. 4).

Figure 4: Percentage of Household Bill Payments Made by Mail and Electronically, Fiscal Years 2000 through 2008

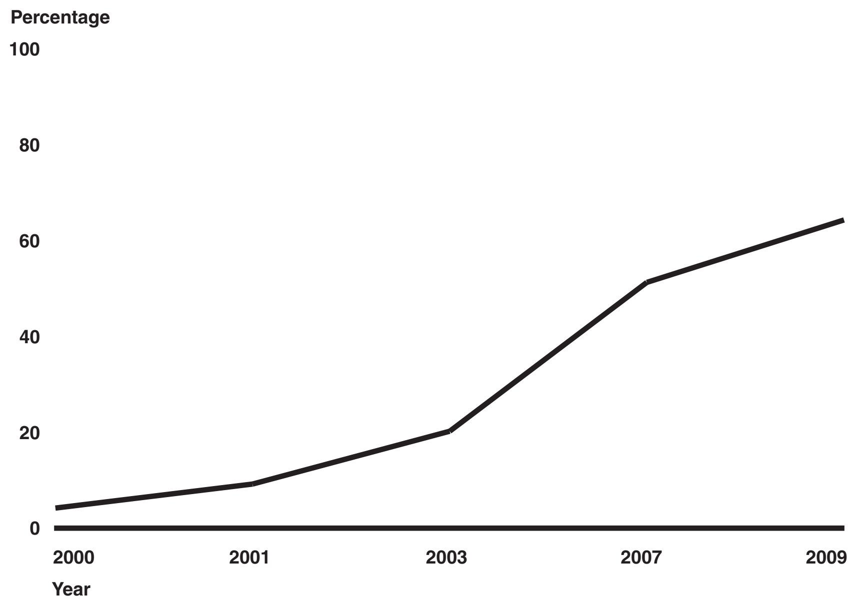


Source: USPS.

Looking forward, the use of electronic alternatives for communications and payments, including broadband and mobile technology, is expected to continue to grow. Nearly two-thirds of American households had broadband service in fiscal year 2008, up from 4.4 percent in less than a decade (see fig. 5). Expanded availability and adoption of broadband technology is being facilitated by federal spending under the American Recovery and Reinvestment Act.[10]

[10]GAO, *Recovery Act: Preliminary Observations on the Implementation of Broadband Programs*, GAO-10-192T (Washington, D.C.: Oct. 27, 2009). Also see GAO, *Recovery Act: Agencies Are Addressing Broadband Program Challenges, but Actions Are Needed to Improve Implementation*, GAO-10-80 (Washington, D.C.: Nov. 16, 2009).

Figure 5: Broadband Use by American Households, 2000 to 2009



Source: U.S. Department of Commerce, National Telecommunications and Information Administration.

USPS Has Made Progress in Reducing Costs but Still Faces Major Cost Pressures

USPS achieved nearly $10 billion in cost savings in the 3 fiscal years 2007 through 2009, primarily by cutting nearly 201 million work hours. Work-hour savings were achieved by workforce reductions of over 84,000 full- and part-time employees, primarily through retirements; reduced overtime; and changes to postal operations. For example, USPS reached agreement with the National Association of Letter Carriers to realign delivery routes, and with the American Postal Workers Union and the National Postal Mail Handlers Union on early retirement incentives. However, USPS's cost savings and added revenue from rate increases and other actions to generate revenues were insufficient to fully offset the impact of declines in mail volume and rising personnel-related costs. Thus, USPS revenues declined by $4.7 billion during this period of time, while its costs declined $7 million.

USPS also has large financial liabilities and obligations that totaled over $88 billion in fiscal year 2009. Over the last 2 fiscal years, total liabilities and obligations have increased by nearly $14 billion (see table 2). USPS debt to the U.S. Treasury, over this same period, increased by $6 billion and pension obligations changed by over $8 billion—from a $5.3 billion surplus to $2.8 billion in unfunded obligations. To put these liabilities and obligations into context, they increased from 100 percent of USPS revenues in fiscal year 2007 to 130 percent of revenues in fiscal year 2009.

Table 2: USPS Financial Liabilities and Unfunded Obligations, Fiscal Years 2007 through 2009

Dollars in billions

	Liabilities				Obligations			
Fiscal year	**Outstanding debt**	**Workers' compensation liabilities**	**Other liabilities[a]**	**Total liabilities**	**Unfunded obligations for retiree health benefits**	**Unfunded obligations (surplus) for pension benefits[b]**	**Total unfunded obligations**	**Total liabilities and obligations**
2007	$4.2	$6.8	$13.7	**$24.7**	$55.0	$(5.3)	**$49.7**	**$74.5**
2008	7.2	7.0	13.5	**27.7**	53.5	2.5	**56.0**	**83.6**
2009	10.2	9.1	14.3	**33.5**	52.0	2.8	**54.8**	**88.3**

Source: USPS.

Note: Data may not add exactly to totals due to rounding.

[a]Other liabilities include many items, such as operating expenses that USPS committed to in fiscal year 2009 but has not yet paid and the value of employees' accumulated leave.

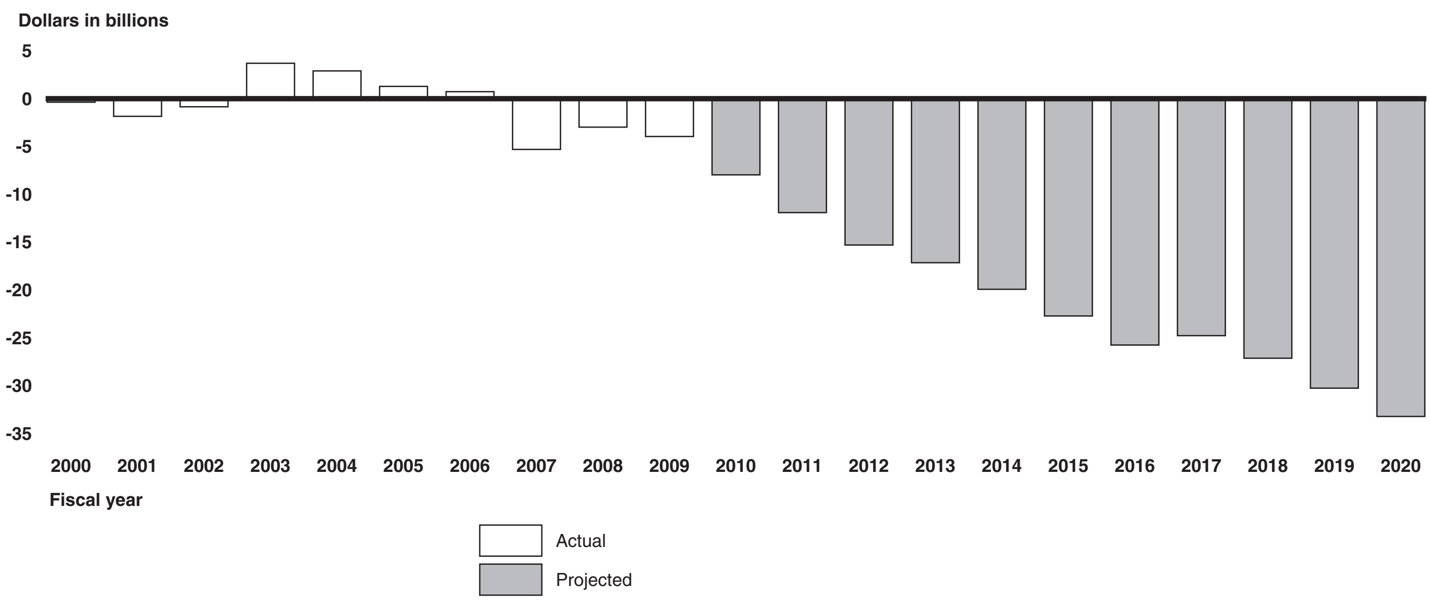
[b]Includes both CSRS and FERS obligations.

USPS's Financial Outlook Is Poor

Declines in mail volume and revenue, large financial losses, increasing debt, and financial obligations will continue to challenge USPS. For fiscal year 2010, USPS is projecting a record loss of over $7 billion and additional pressures to generate sufficient cash to meet its obligations. Furthermore, it has halted construction of most new facilities and has budgeted $1.5 billion in capital cash outlays (mostly for prior commitments), which is down from the average of $2.2 billion in the previous 5 fiscal years. USPS also expects to borrow $3 billion in fiscal year 2010, which would bring its total outstanding debt to $13.2 billion, close to its $15 billion statutory limit.

Looking forward, USPS projects that, absent additional action, annual financial losses will escalate over the next decade to $33 billion in fiscal year 2020 (see fig. 6). According to USPS, its projected losses will result from declining mail volume, stagnant revenue (despite rate increases), large costs to provide universal service, and rising workforce costs. These projections are the most pessimistic in many years. Stakeholder interviews reinforce the conclusion that the recent recession was a "tipping point" that has accelerated the diversion of mail to electronic alternatives, particularly among business mailers who generate the most mail volume and revenues, leading to sobering financial results.

Figure 6: USPS Actual and Projected Net Income (Loss), Fiscal Years 2000 through 2020



Source: USPS.

Note: The projection for fiscal year 2010 is from USPS's Fiscal Year 2010 Integrated Financial Plan. USPS projections for fiscal years 2011 through 2020 are from its *Action Plan* and assume that (1) USPS takes no management actions beyond those in its fiscal year 2009 budget and (2) USPS's total statutory borrowing limit of $15 billion would be increased to accommodate these losses. USPS's $8.4 billion in cumulative net income for fiscal years 2003 through 2005 largely resulted from a 2003 law (Pub. L. No. 108-18) that reduced USPS pension benefit payments by about $9 billion over this period.

Strategies and Options That Address Challenges to USPS's Current Business Model

Making progress toward USPS's financial viability would primarily involve taking action on strategies and options to rightsize operations, cut costs, and increase revenues. USPS does not need—and cannot afford to maintain—its costly excess infrastructure capacity. USPS has achieved noteworthy cost reductions, but much more progress is needed. Making the necessary progress would require (1) taking more aggressive actions to reduce costs and increase revenues within its current authority, using the collective bargaining process to address wages, benefits, and workforce flexibility, and (2) congressional action to address legal restrictions and resistance to realigning USPS operations, networks, and workforce. Key strategies and options, some of which would require statutory changes, fall into the following three major categories:

- reducing compensation and benefits costs,
- reducing other operations and network costs and improving efficiency, and
- generating revenues through product and pricing flexibility.

Ultimately, Congress may want to examine other options that would alter the ownership structure of USPS. For example, USPS might be moved back to being a federal agency funded in part by taxpayer support, or it might be moved to a corporate model. This report does not address the ownership issue because of an array of functional and operational options—discussed throughout this report—that need to be examined immediately. The resolution of some of these more pressing issues might afford a better understanding of whether the ownership structure should be modified.

Options to Reduce Compensation and Benefits Costs

USPS has options to reduce its compensation and benefits costs in the following four key areas: workforce size, to be aligned with reduced workload; wages, which continue to be a key component of costs; benefits, which in some cases are more generous than those provided by other federal agencies; and workforce flexibility, including the mix of full- and part-time employees and work rules that govern what tasks employees can perform. Changes in these areas would need to be negotiated with employee unions and would involve tradeoffs between reducing costs and addressing union concerns that reducing workforce size and compensation and benefits would erode the number of well-paying jobs.

About 85 percent of USPS employees are covered by collective bargaining agreements, which correspond with major crafts (see table 3). USPS and its employee unions will begin negotiations for new agreements in 2010 and 2011. If USPS and its unions are unable to agree, binding arbitration by a third-party panel will ultimately be used to establish agreement. USPS is also required to consult with its management associations that represent postmasters and supervisors. About 78 percent of USPS employees are full time and receive salary increases and cost-of-living adjustments based on predetermined levels. These employees are generally scheduled in 8-hour shifts and can earn overtime pay, except for rural mail carriers, who are generally paid a salary without overtime. Managers are not covered by collective bargaining agreements and are compensated under a pay-for-performance program. About 90 percent of city carriers are full time, while about 55 percent of rural carriers are full time.

Table 3: USPS Employees Covered by Selected Union Contracts as of September 30, 2009

Craft	Number of employees	Name of union	Contract expiration date
Clerks	177,842	American Postal Workers Union	November 20, 2010
Mail Handlers	52,954	National Postal Mail Handlers Union	November 20, 2011
City Carriers	200,658	National Association of Letter Carriers	November 20, 2011
Rural Carriers	122,278[a]	National Rural Letter Carriers' Association	November 20, 2010
Total	**553,732**		

Sources: USPS and employee unions.

[a]Includes 54,529 part-time rural carriers.

USPS has not achieved significant reductions in compensation and benefits, in part due to the following challenges:

- USPS is required by law to maintain compensation and benefits comparable to the private sector. The application of the comparability standard to postal employees—that is, whether a compensation premium exists between postal employees and private-sector employees who do comparable work—has been a source of disagreement between management and postal unions in negotiations and interest arbitration.
- Career USPS employees participate in federal pension and benefits programs, including health care and life insurance. USPS collective bargaining agreements include provisions to reduce USPS's contribution to health care premiums by 1 percent a year from 85 percent in fiscal year 2007 to 81 percent in 2011 or 80 percent in 2012, depending on the agreement. Nevertheless, USPS covers a higher proportion of employee premiums for health care and life insurance than most other federal agencies. The law requires USPS's fringe benefits to be at least as favorable as those in effect when the PRA of 1970 was enacted.[11]
- USPS is also required by law to participate in the federal workers' compensation program[12] and ensure coverage for injured employees. Some benefits provided under the federal program exceed those provided in the private sector. For example, injured USPS employees with dependents receive 75 percent of their salary compared with the 66 percent of pay private employers covered under state workers'

[11]39 U.S.C. § 1005(f).

[12]39 U.S.C. § 1005(c).

compensation laws typically provide. Furthermore, USPS employees receiving this benefit often do not opt to retire when eligible, staying permanently on the more generous workers' compensation rolls.

- Current collective bargaining agreements include provisions related to compensation, leave, workforce composition, and work rules. They also include some provisions that allow USPS to make changes, such as relocating employees, but other provisions limit USPS's flexibility to manage work efficiently and rightsize its workforce. For example, current collective bargaining agreements

    - limit the percentage of part-time and contract workers who help USPS match its workforce to changing workload;

    - limit managers from assigning work to employees outside of their crafts, such as having a retail clerk deliver mail;

    - limit outsourcing for city delivery routes; and

    - contain "no-layoff" provisions for about 500,000 employees and require USPS to release lower-cost part-time and temporary employees before it can layoff any full-time workers without layoff protection.

- Currently, if the collective bargaining process reaches binding arbitration, there is no statutory requirement for USPS's financial condition to be considered. In 2009, proposed Senate legislation[13] included language that would require any binding arbitration in the negotiation of postal contracts to take the financial health of the Postal Service into account.

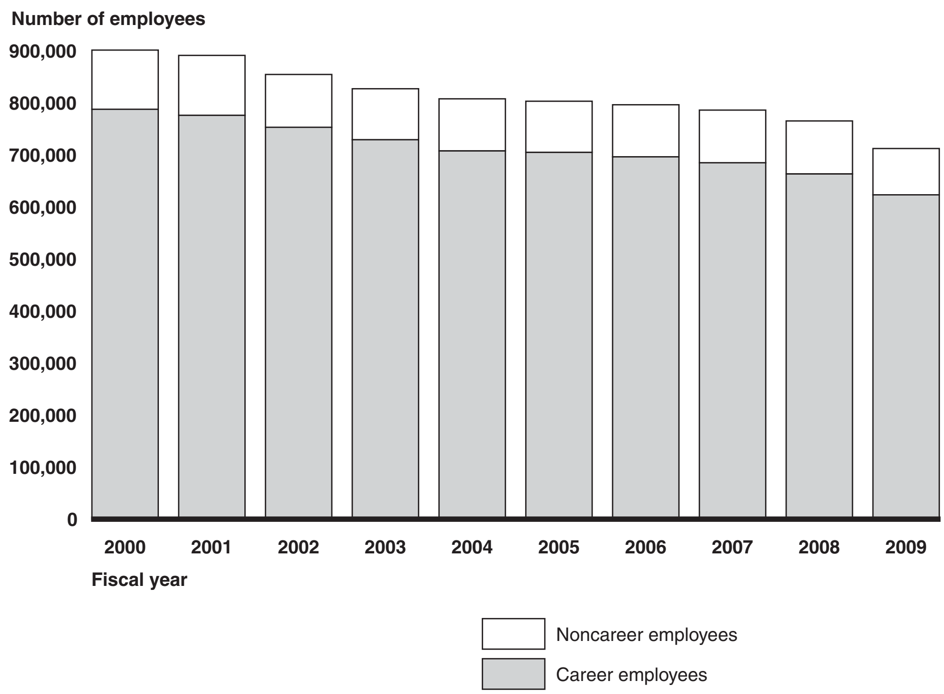
Workforce Size

The 2003 President's Commission reported that "far more than individual benefits, the size of the [postal] workforce determines the cost of the workforce." USPS has worked to reduce the size of its workforce through regular retirements and early retirements in response to recent separation incentives and through a hiring freeze. USPS's workforce of career and noncareer employees declined by nearly 21 percent—from 901,238 at the end of fiscal year 2000 to 712,082 at the end of fiscal year 2009 (see fig. 7). Career employees continued to comprise most of the total workforce throughout this period. USPS has a window of opportunity to reduce the cost and size of its workforce through the large number of upcoming retirements, minimizing any need for layoffs. In this regard, about 5

[13]S. 1507, 111th Cong. (2009).

percent of USPS employees will be eligible and expected to retire each year through 2020—a total of approximately 300,000 employees. Key issues include what size workforce is needed to reflect changes in mail volumes, revenues, and operations; how quickly changes can be made in this area; whether separation incentives should be offered and are affordable; and to what extent and under what terms should outsourcing be considered.

Figure 7: Total Career and Noncareer Postal Employees, Fiscal Years 2000 through 2009



Source: USPS.

Options to reduce the size of USPS's workforce include the following:

- *Retirement and separation incentives:* According to USPS officials, incentives could accelerate the rate of attrition, but it needs to have sufficient cash to fund them.
- *Outsourcing:* Determine which functions would be cost-effective to outsource (using companies or individuals). At the end of fiscal year 2009, USPS had about 36,500 retail facilities, 3,000 of which were contract postal units and 800 of which were community post offices staffed by nonpostal employees. USPS also has long outsourced most of its long-distance air

and ground transportation. In delivery operations, contractors deliver to less than 2 percent of USPS's delivery points. Postal labor unions and some Members of Congress have previously resisted outsourcing. For example, after USPS attempted to contract out some city delivery routes in 2007, legislation was introduced in both Houses of Congress on this matter.[14] USPS and the National Association of Letter Carriers subsequently agreed to a moratorium on outsourcing city carrier delivery through November 2011. Looking forward, the outsourcing issue could involve consideration of the tradeoffs between the loss of government jobs paying middle-class wages and benefits to achieve savings by shifting the work to private-sector jobs that may pay lower wages and not have guaranteed benefits.

- *Layoffs:* USPS could implement layoffs as a last resort if it has too few positions to offer employees affected by restructuring. For example, USPS could implement layoffs as part of shifting from 6-day delivery to 5-day delivery. However, under current collective bargaining agreements, any layoffs of covered employees not protected by no-layoff clauses must first be applied to noncareer employees, such as temporary employees, whose average wages are less than full-time career employees.

Wages

USPS wages were $39 billion in fiscal year 2009—about one-half of its costs. Increasing wages have been a key driver of additional costs, expected to add $1 billion in fiscal year 2010. Wages have traditionally increased on the basis of cost-of-living allowances keyed to the Consumer Price Index. Rising wages also increase benefit costs, such as pensions. Key issues include how USPS can improve its compensation systems to balance the need for fair compensation with reducing costs and increasing incentives to become more competitive. In this regard, a recent legislative proposal would have required that USPS's financial condition be considered if collective bargaining reaches binding arbitration.[15] One option would be a two-tier pay system that would pay new hires lower wages, while "grandfathering" current employees under the current pay structure.

[14]The Mail Delivery Protection Act of 2007, S. 1457, 110th Cong. (2007) would have restricted contracting for mail delivery. The Mail Network Protection Act of 2007, H.R. 4236, 110th Cong. (2007), specified conditions that must be met before USPS entered into some contracts, such as for surface transportation of mail. Additionally, H.Res. 282, 110th Cong. (2007), expressed "the sense of the House of Representatives that the United States Postal Service should discontinue the practice of contracting out mail delivery services."

[15]Postal Service Retiree Health Benefits Funding Reform Act of 2009, S. 1507, 110th Cong. (2009).

Benefits

USPS makes payments to fund its liabilities and obligations for retiree health and pension benefits, health and life insurance premiums, and workers' compensation.[16] Benefits cost USPS almost $17 billion in fiscal year 2009, over 23 percent of its total costs. The cost would have been nearly $21 billion if Congress had not reduced USPS payments for retiree health benefits by $4 billion to address a looming cash shortfall. Key issues are assigning financial responsibility for benefits to USPS, its employees, and current and future ratepayers and balancing USPS's poor financial condition, while keeping rates affordable, meeting legal requirements for employee benefits, and minimizing risk to the taxpayer if USPS would be unable to meet its responsibilities.

Retiree Health Benefits

According to OPM estimates, at the end of fiscal year 2009, the actuarially determined obligation for USPS's future retiree health benefits was about $87.5 billion. At that time, the dedicated Postal Service Retiree Health Benefits Fund (the RHB Fund) had a balance of $35.5 billion, and, therefore, unfunded obligations of $52.0 billion remained. These unfunded obligations developed largely because, prior to the enactment of PAEA in 2006, USPS financed its share of the health insurance premiums for its retirees on a pay-as-you-go basis, rather than on the annual accrued cost of future benefits attributable to the service of current employees. PAEA required USPS to begin prefunding its retiree health benefit obligations with annual payments to the RHB Fund, while continuing to pay its share of the retiree health premiums of current retirees to the Federal Employees Health Benefits Fund (the FEHB Fund).

Since PAEA was enacted, mail volume has declined, USPS's financial condition has deteriorated, and it has had difficulty in making its required payments to prefund its retiree health benefit obligations. In fiscal year 2009, a looming cash shortfall led to last-minute congressional action that deferred costs by reducing USPS's required prefunding payment from $5.4 billion to $1.4 billion. At the end of fiscal year 2009, USPS had about 463,000 annuitants and survivors participating in the Federal Employees Health Benefits Program. Furthermore, 162,000 USPS career employees are eligible for regular retirement this fiscal year, and this number is projected to increase to about 300,000 career employees over the next

[16] USPS accounts for its participation in the federal government's health and pension plans by recognizing these contributions as an expense. This accounting method is based on private-sector standards that employers use to account for multiemployer benefit plans.

decade. For fiscal year 2010, USPS has reported that it is “highly uncertain” whether it will have sufficient cash to cover its required prefunding payment of $5.5 billion that is due by September 30, 2010. According to USPS’s fiscal year 2010 budget, by making the required prefunding payment, it will end the fiscal year with a cash balance of only $200 million. However, USPS officials have said that this cash balance would likely be inadequate to finance operations in October 2010, when it must make three payroll payments of close to $2 billion each, as well as a payment for workers’ compensation costs expected to exceed $1 billion. In response to these likely conditions, USPS has requested that Congress revise the required schedule for retiree health benefits payments as part of a package to improve its financial viability.

There are multiple options for funding USPS’s retiree health benefit obligations. In addition to the current prefunding approach, where the obligations are paid prior to when USPS’s share of retiree health premiums are due, there are two broad approaches—(1) a “pay-as-you-go” funding approach, where USPS’s share of retiree health premiums are paid as they are billed for current retirees, and (2) an actuarial funding approach, where payments include amounts for “normal costs” to finance the future retiree health benefits attributed to the service of current employees and amortization amounts to liquidate unfunded obligations over a 40-year period. The impact of these various approaches on USPS’s payments would depend on whether its share of retiree health premiums would be paid directly by USPS to the FEHB Fund or whether the premiums would be paid from the RHB Fund. Depending on which option is selected, changes could also impact the federal budget deficit. PAEA’s approach to funding USPS’s retiree health benefit obligations is a combination of the prefunding and pay-as-you-go approaches that we have previously described. Specifically, PAEA requires USPS to make two payments annually over fiscal years 2010 through 2016:

- a payment to the FEHB Fund to cover its share of the premiums for current retirees and

- a statutorily determined payment to the RHB Fund to prefund obligations for future retirees.

Starting in fiscal year 2017—after the last statutorily scheduled prefunding payment—PAEA requires that USPS’s share of retiree health premiums be paid from the RHB Fund and requires OPM to determine future payments to the RHB Fund. Each annual payment to the RHB Fund starting in fiscal year 2017 will be the sum of the two amounts that finance the following:

- the annual accrued cost of future benefits attributable to the service of current USPS employees, which OPM refers to as "normal costs," and

- amortization payments over 40 years to liquidate any unfunded obligations.[17]

Table 4 shows USPS payments from fiscal years 2010 through 2020, based on updated estimates that OPM provided to us for this report. Total USPS payments are estimated to increase from $7.8 billion in fiscal year 2010 to $10.3 billion in fiscal year 2016. The payments are estimated to decline to $6.4 billion in fiscal year 2017 and increase to $7.3 billion in fiscal year 2020. Based on GAO analysis, assuming that USPS made these payments through 2020, estimated unfunded obligations of about $33 billion would remain.

Table 4: USPS Retiree Health Benefit Payments under Current Law, Fiscal Years 2010 through 2020, which Include Prefunding through Fiscal Year 2016

Dollars in billions

Fiscal year	USPS payments to RHB Fund	USPS payments to FEHB Fund	Total USPS payments	Payments from RHB Fund to FEHB Fund
2010	$5.5	$2.3	**$7.8**	$0.0
2011	5.5	2.6	**8.1**	0.0
2012	5.6	2.9	**8.5**	0.0
2013	5.6	3.3	**8.9**	0.0
2014	5.7	3.6	**9.3**	0.0
2015	5.7	4.0	**9.7**	0.0
2016	5.8	4.5	**10.3**	0.0
2017	6.4	0.0	**6.4**	4.9
2018	6.7	0.0	**6.7**	5.4
2019	7.0	0.0	**7.0**	5.8
2020	7.3	0.0	**7.3**	6.4
Total	**$66.8**	**$23.2**	**$90.0**	**$22.5**

Source: OPM analysis prepared at GAO's request.

[17] Pub. L. No. 109-435, § 803.

Note: Estimates are based on OPM assumptions that factor in updated USPS workforce size projections, annual inflation in health care costs of 8 percent in fiscal year 2010 that then declines slowly, a general inflation rate of 3.5 percent annually, and RHB Fund interest of 6.25 percent annually. USPS prefunding payments are specified in PAEA and are shown above as USPS Payments to RHB Fund for fiscal years 2010 through 2016. Starting in fiscal year 2017, annual USPS payments will include (1) "normal costs" (i.e., future retiree health benefits costs attributed to the service of current employees) and (2) amortization amounts to liquidate any unfunded obligations over a 40-year period.

In 2009, proposed legislation was introduced in both houses of Congress that would have revised the payment schedule for postal retiree health benefits.[18] The House legislation (H.R. 22) would have shifted responsibility for payments for current retiree health premiums from USPS to the RHB Fund for fiscal years 2009 through 2011. Such action would result in USPS needing to pay additional amounts to the RHB Fund in the future due to the use of those RHB funds for current retiree health premiums. The Congressional Budget Office (CBO) estimated that enacting the House legislation would have a net cost to the federal budget of $2.5 billion over fiscal years 2010 through 2019.[19] The Senate legislation (S. 1507) would have extended and revised prefunding payments to the RHB Fund, with the payment amounts increasing from $1.7 billion in fiscal years 2009 and 2010 to $5.3 billion in fiscal year 2019. CBO estimated that enacting S. 1507 would have a net cost to the federal budget of $2.8 billion over both fiscal years 2010 through 2019 and fiscal years 2009 through 2014.[20] Ultimately, Congress acted at the end of September 2009 to reduce costs by deferring USPS's prefunding payment for retiree health benefits in fiscal year 2009 by $4 billion.[21]

We strongly support the principle that USPS should continue to fund its retiree health benefit obligations to the maximum extent that its finances permit. Deferrals of funding such benefits would serve as financial relief. Such deferrals, however, increase the risk that in the future USPS will not be able to pay these obligations as its core business continues to decline and if sufficient actions are not taken to restructure operations and reduce costs. With these considerations, the current statutory approach for

[18]H.R. 22, 111th Cong. (2009); S. 1507, 111th Cong. (2009).

[19]Congressional Budget Office, *H.R. 22: United States Postal Service Financial Relief Act of 2009* (Washington, D.C.: July 20, 2009).

[20]Congressional Budget Office, *S. 1507: Postal Service Retiree Health Benefits Funding Reform Act of 2009* (Washington, D.C.: Sept. 14, 2009).

[21]H.R. 2918, 111th Cong. (2009), enacted as Pub. L. No. 111-68 (2009).

funding USPS's retiree health benefit obligations can be revised along the lines of the two broad approaches to funding retiree health obligations—pay-as-you-go and actuarial. The approaches vary in the amount of annual payments, which, in turn, impact the unfunded obligation, lower annual payments, and result in higher unfunded obligation balances. For comparison purposes, we present the estimated unfunded balance for USPS's retiree health obligations in fiscal year 2020. These approaches to revising the current statutory approach are presented in the following text to illustrate the wide range of possible options.

Approach #1: Pay-as-you-go approach to funding retiree health benefit obligations

In March 2010, USPS proposed "to shift to a 'pay-as-you-go' system [for its retiree health benefits], paying premiums as they are billed" for current retirees. Estimated annual USPS payments under one possible pay-as-you-go approach are shown in table 5. Under this approach, USPS would make payments to the FEHB Fund for its share of retiree health premiums. The RHB Fund would not make or receive payments, but would continue to earn interest. Based on GAO analysis, USPS's unfunded obligations would be an estimated $99 billion in fiscal year 2020, or about $66 billion more than they would be under current law. This level of unfunded obligations would increase the risk that, absent future events that could reduce USPS's retiree health premiums, USPS's operations in the future may not be able to support the future payments that are expected. However, in such a circumstance, a mechanism could be created to pay a portion of premium payments from the assets that have accumulated in the RHB Fund once a threshold was reached, such as when the pay-as-you-go premium payments reach a particular percentage of postal revenues. Using the RHB Fund to pay a portion of retiree health premiums would reduce USPS's payments to the FEHB Fund and increase USPS's unfunded obligations by a corresponding amount. Such a mechanism could, if implemented carefully, provide some assistance to USPS in meeting its obligation to pay retiree health premiums.

Table 5: A Pay-as-You-Go Approach for Revising USPS Retiree Health Benefit Payments, Fiscal Years 2010 through 2020

Dollars in billions

Fiscal year	USPS payments to RHB Fund	USPS payments to FEHB Fund	Total USPS payments	Payments from RHB Fund to FEHB Fund	Difference between total USPS payments under this option and current law[a]
2010	$0.0	$2.3	**$2.3**	$0.0	$(5.5)
2011	0.0	2.6	**2.6**	0.0	(5.5)
2012	0.0	2.9	**2.9**	0.0	(5.6)
2013	0.0	3.3	**3.3**	0.0	(5.6)
2014	0.0	3.6	**3.6**	0.0	(5.7)
2015	0.0	4.0	**4.0**	0.0	(5.7)
2016	0.0	4.5	**4.5**	0.0	(5.8)
2017	0.0	4.9	**4.9**	0.0	(1.5)
2018	0.0	5.4	**5.4**	0.0	(1.3)
2019	0.0	5.8	**5.8**	0.0	(1.2)
2020	0.0	6.4	**6.4**	0.0	(0.9)
Total	**$0.0**	**$45.7**	**$45.7**	**$0.0**	**$(44.3)**

Source: OPM analysis prepared at GAO's request.

Note: Estimates are based on OPM assumptions that factor in updated USPS workforce size projections, annual inflation in health care costs of 8 percent in fiscal year 2010 that then declines slowly, a general inflation rate of 3.5 percent annually, and RHB Fund interest of 6.25 percent annually.

[a]GAO compiled the data shown in this column. Also, see table 4 for USPS payments under current law.

Different variations on a "pay-as-you-go" approach are also possible, such as using the RHB Fund to pay USPS's share of retiree health premiums for current retirees until the RHB Fund is exhausted and then reverting to USPS funding future premiums from its operations by paying the FEHB Fund directly. Under this alternative, USPS's payments would be suspended until the RHB Fund is exhausted, which would be approximately fiscal year 2025.

Approach #2: Actuarial approach to funding retiree health benefit obligations

An actuarial funding approach for USPS retiree health benefit obligations could provide a financing mechanism that allows the RHB Fund to remain self-sustaining in the long term. Under one such approach, unfunded retiree health benefit obligations would be reamortized starting in fiscal year 2010, instead of fiscal year 2017, as required under current law.

Specifically, starting in fiscal year 2010, USPS would make payments to the RHB Fund that finance the following:

- the annual accrued cost of future benefits attributable to the service of current USPS employees, which OPM refers to as “normal costs,” and
- amortization payments over 40 years to liquidate any unfunded obligations.

Under this actuarial funding approach, USPS would make annual estimated payments that total about $80 billion from fiscal years 2010 through 2020 (see table 6). Based on GAO analysis, in fiscal year 2020, the estimated unfunded obligations under this method would be about $48 billion, or about $15 billion more than they would be under current law.

Table 6: Actuarial Funding Alternative for USPS Retiree Health Benefit Payments, Fiscal Years 2010 through 2020

Dollars in billions

Fiscal year	USPS payments to RHB Fund[a]	USPS payments to FEHB Fund	Total USPS payments	Payments from RHB Fund to FEHB Fund	Difference between total USPS payments under this option and current law[b]
2010	$6.3	$0.0	**$6.3**	$2.3	$(1.5)
2011	6.4	0.0	**6.4**	2.6	(1.7)
2012	6.5	0.0	**6.5**	2.9	(2.0)
2013	6.8	0.0	**6.8**	3.3	(2.1)
2014	7.0	0.0	**7.0**	3.6	(2.3)
2015	7.2	0.0	**7.2**	4.0	(2.5)
2016	7.5	0.0	**7.5**	4.5	(2.8)
2017	7.7	0.0	**7.7**	4.9	1.3
2018	8.0	0.0	**8.0**	5.4	1.3
2019	8.3	0.0	**8.3**	5.8	1.3
2020	8.6	0.0	**8.6**	6.4	1.3
Total	**$80.3**	**$0.0**	**$80.3**	**$45.7**	**$(9.7)**

Source: OPM analysis done at GAO’s request.

Note: Estimates are based on OPM assumptions that factor in updated USPS workforce size projections, annual inflation in health care costs of 8 percent in fiscal year 2010 that then declines slowly, a general inflation rate of 3.5 percent annually, and RHB Fund interest of 6.25 percent annually.

[a]Starting in fiscal year 2010, USPS payments include (1) amounts for “normal costs” (i.e., future retiree health benefits costs attributed to the service of current USPS employees) and (2) amortization amounts to liquidate any unfunded obligations over a 40-year period.

[b]GAO compiled the data shown in this column. Also, see table 4 for USPS payments under current law.

PAEA's funding requirements represent a significant financial commitment for USPS, especially in light of the current economic environment and the major challenges it faces. As we have testified, we continue to be concerned about those options that would greatly reduce payments in the short term, only to defer payments into the future.[22] Specifically, we are concerned that deferring these payments or some portion into the future increases the risk that USPS may have difficulty in making the future payments, particularly if mail volumes continue to decline. Because its retirees are eligible to receive the same health benefits as other federal retirees, if USPS cannot make its required payments, the U.S. Treasury, and hence the taxpayer, would still have to meet the federal government's obligations.

Pension Benefits

USPS employees participate in the federal government's two civilian pension plans—the Civil Service Retirement System (CSRS) and the Federal Employees' Retirement System (FERS)—that are administered by OPM. As of the end of fiscal year 2009, approximately 80 percent of USPS's employees were enrolled in FERS, while 20 percent were enrolled in CSRS or the Dual Civil Service Retirement System and Social Security (Dual CSRS).[23] As an agency employer, USPS is required by law to make certain payments to the Civil Service Retirement and Disability Fund (CSRDF) to fund its share of CSRS and FERS pension costs. In addition to providing an annuity at retirement based on years of service and "high-3" average pay, FERS also consists of Social Security and the government's Thrift Savings Plan (TSP). As such, USPS contributes the employer's share of Social Security taxes and the required contributions to its employees' TSP accounts.

Because USPS's pension, Social Security, and TSP contributions are in part a function of employee wages as defined for these programs, changes in total employee wages will have a corresponding effect on USPS's costs for these items. USPS's retirement expenses were $5.9 billion in fiscal year 2009. As we have previously mentioned, most USPS employees are full

[22]GAO, *U.S. Postal Service: Deteriorating Postal Finances Require Aggressive Actions to Reduce Costs*, GAO-09-332T (Washington, D.C.: Jan. 28, 2009).

[23]Employees with prior U.S. government service who were hired between January 1, 1984, and January 1, 1987, are covered by Dual CSRS. Less than 1 percent of USPS employees are covered by this plan.

time, can receive overtime pay, and receive pay increases and cost-of-living adjustments as set forth in collective bargaining agreements with various unions. Other USPS employees, typically managers and postmasters, are compensated under pay-for-performance programs. USPS's ability to reduce the size of its workforce and the number of workhours, the strategies and options for which are described elsewhere in this report, will affect the pension, Social Security, and TSP benefit costs it incurs for most of its employees.

Furthermore, the methods and rates at which USPS funds pension benefit costs are set forth in law. In 2002, OPM estimated that, under statutory pension funding requirements applicable to USPS at the time, USPS was on course to overfund its CSRS pension obligations.[24] Congress responded by enacting the Postal Civil Service Retirement System Funding Reform Act of 2003,[25] which changed the prior method of estimating and funding the USPS CSRS pension obligations. The act required USPS to contribute the employer's share of "dynamic normal cost" to the CSRDF, plus an amount to liquidate any underfunding, or "postal supplemental liability," both as determined by OPM.[26] In July 2003, OPM submitted to Congress its plan enumerating the actuarial methods and assumptions by which OPM would make its determinations. In 2004, OPM and the Board of Actuaries for the CSRDF reconsidered OPM's methodology at the request of USPS and concluded that OPM's methodology was in accordance with

[24]USPS contributed 7 percent of its CSRS employees' basic pay to the CSRDF when the Postal Reorganization Act was enacted in 1970. Subsequently, Congress periodically enacted legislation that required USPS to make additional CSRS contributions, primarily for the effect of increases in pension liabilities resulting from increases in employee pay and annuitant cost-of-living adjustments. See GAO, *Review of the Office of Personnel Management's Analysis of the United States Postal Service's Funding of Civil Service Retirement System Costs*, GAO-03-448R (Washington, D.C.: Jan. 31, 2003), appendix II, for a listing and description of key legislation affecting USPS's funding of CSRS costs.

[25]Pub. L. No. 108-18, 117 Stat. 624 (Apr. 23, 2003). See S. Rep. No. 108-35, at 2 (2003).

[26]Postal supplemental liability is the estimated difference of the actuarial present value of retirement obligations for USPS employees less the sum of several items, including the present value of future employer normal cost contributions and employee contributions to the CSRDF; the portion of the CSRDF balance attributable to payments to the CSRDF; and any other appropriate amount determined by OPM under generally accepted actuarial practices and principles. The current requirement is codified, as amended, at 5 U.S.C. § 8348(h). In determining USPS's CSRS contributions, Congress required the use of "dynamic assumptions," which are defined as economic assumptions that are used in determining actuarial costs and liabilities of a retirement system and in anticipating the effects of long-term future investment yields; increases in rates of basic pay; and rates of price inflation.

congressional intent. OPM also rejected an alternative methodology offered by USPS.

In January 2010, the USPS OIG issued a report on funding the USPS's CSRS pension responsibility.[27] This report asserted that, despite the changes brought about in the 2003 Act, the current method of allocating the pension costs for post-1971 pay increases results in the inequitable allocation of pension obligations to USPS. The USPS OIG proposed an alternative allocation methodology that its actuaries estimated would, if implemented, change the funded status of USPS's CSRS pension obligations from a current $10 billion underfunding to a $65 billion overfunding. This alternative allocation methodology is the same methodology that OPM rejected in 2004. Application of the USPS OIG's proposed methodology would result in a shift of pension funding costs from USPS to the U.S. Treasury.

Other Benefits

- *Health and life insurance:* Health insurance premiums for current employees comprise a growing share of USPS expenses, rising from $2.2 billion (3.5 percent of total expenses) in fiscal year 2000 to $5.3 billion (7.4 percent) in fiscal year 2009. Collective bargaining agreements require USPS to pay a more generous share of employees' health and life insurance premiums than most other agencies. For example, USPS paid, on average, 81 percent of health benefit premiums in fiscal year 2009 compared with 72 percent by other federal agencies. It also paid 100 percent of employee life insurance premiums, while other federal agencies pay about 33 percent. One option would be to increase employee premium payments for health and life insurance premiums. USPS's share of the health and life insurance premium payments could be reduced to levels paid by most federal agencies, which would increase the employees' annual premium payments and, according to USPS estimates, would have saved about $615 million in fiscal year 2009.

- *Workers' compensation:* The 2003 President's Commission recommended making USPS's workers' compensation program more comparable to programs in the private sector to control costs, still provide adequate benefits, and address USPS's unfunded liability in this area. The commission recommended that USPS be allowed to (1) transition

[27]United States Postal Service, Office of Inspector General, *The Postal Service's Share of CSRS Pension Responsibility,* RARC-WP-10-001 (Arlington, Va.: Jan. 20, 2010).

employees receiving workers' compensation to its pension plan on the basis of when the employee (if not injured) would be retirement eligible and (2) limit benefits from the current 75 percent for employees with dependents to two-thirds of the maximum weekly rate—the rate that applies to employees without dependents.

Postal Workforce Mix and Work Rules

Limitations on the workforce mix of full-time and part-time postal employees and workforce flexibility rules contained in contracts with USPS's unions are key determinants of how postal work is organized and, thus, of its cost. USPS officials told us that as mail volume declines, it would be more efficient to have a much higher proportion of part-time workers than is currently allowed under the existing agreements. These part-time employees would have flexible schedules and responsibilities and lower pay than full-time career employees. A key issue is how USPS can obtain greater flexibility through the collective bargaining process so that it can adjust its workforce more quickly to adapt to changing volume and revenue. Some options for postal workforce mix and work rules include the following:

- *Part-time workers:* Increase the percentage of part-time employees, who could work more flexible schedules, including less than an 8-hour shift. Such flexibility could help match USPS's workforce to the changing workload, which varies greatly depending on the day of the week and the time of the year.

- *Job Flexibility:* Increase the flexibility to use employees in different assignments. Changes in the skill requirements of some jobs and the needs of operations have made it more feasible and necessary for employees to be trained in different tasks and work in different areas, depending on daily needs. Under current collective bargaining agreements, USPS can assign employees to "cross crafts" and perform different duties, but the agreements require managers to consider wage level, knowledge, and experience before asking employees to perform duties outside of their normal purview.

Options for Reducing Operational and Network Costs and Improving Efficiency

Another area where USPS can reduce operational costs is by optimizing its mail processing, retail, and delivery networks; eliminating growing excess capacity and maintenance backlogs; and improving efficiency. Declines in mail volume and continuing automation have increased costly excess capacity that was a problem even when mail volume peaked in fiscal year 2006. USPS no longer needs—and can no longer afford—to maintain all of its retail and mail processing facilities. For example, USPS has reported that it has 50 percent excess plant capacity in its First-Class Mail processing operations.

Although USPS has begun efforts to realign and consolidate some mail processing, retail, and delivery operations, additional efforts are urgently needed to overcome obstacles. USPS has faced formidable resistance to facility closures and consolidations because of concerns about how these actions might affect jobs, service, employees, and communities, particularly in small towns or rural areas. According to some Members of Congress and postmaster organizations, among others, post offices are fundamental to the identity of small towns, providing them with an economic and social anchor. Another issue is that inadequate USPS financial resources could impede efforts to optimize postal mail processing, retail, and delivery networks by limiting available funding for transition costs.

Reducing operational and network costs would require navigating statutory requirements, regulations, procedures, and service standards, including the following:

- USPS is required by law to provide adequate, prompt, reliable, and efficient services to all communities, including a maximum degree of effective and regular services in rural areas, communities, and small towns where post offices are not self-sustaining.[28] USPS is specifically prohibited from closing small post offices "solely for operating at a deficit."[29] Statutory requirements also specify the process and criteria for post office closings, including appellate review by PRC.[30] Also, USPS regulations prescribe processes for closing, consolidating, and relocating post offices.

- PAEA requires USPS to develop and use procedures for providing public notice and input before closing or consolidating any mail processing or logistics facilities.[31]

- Appropriations provisions restrict post office closures[32] and mandate 6-day delivery.[33]

[28]39 U.S.C. § 101.

[29]39 U.S.C. § 101(b).

[30]39 U.S.C. § 404(d).

[31]Pub. L. No. 109-435, § 302(c)(5).

- Service standards drive operations at mail processing facilities. In this regard, PAEA requires USPS to establish and maintain modern delivery standards.[34] USPS standards currently call for delivery of most local First-Class Mail overnight and most long-distance First-Class Mail in 2 to 3 days.

- A PRC hearing and advisory opinion are required when USPS submits a proposal to make changes that would generally affect service on a nationwide or substantially nationwide basis.[35]

Mail Processing Operations

In 2006, PAEA encouraged USPS to expeditiously move forward in its streamlining efforts, recognizing that USPS has more processing facilities than it needs.[36] USPS has begun efforts to consolidate some mail processing operations, but much more needs to be done. Since 2005, USPS has closed only 2 of its 270 processing and distribution centers. Over this period, it also has closed some facilities, such as 68 Airport Mail Centers and 12 Remote Encoding Centers.[37] Between fiscal years 2005 and 2009, the Area Mail Processing (AMP) process has been used to implement 13 consolidations, saving a projected $31 million, but 39 under consideration were canceled, according to a recent USPS OIG report.[38] This report also noted that another 16 AMP consolidations have been approved, while 30 remained under consideration.

When determining whether to close a particular mail processing facility, key factors include the role of the facility in providing secure and timely delivery in accordance with its service standards as well as the expected cost reductions or productivity gains. Furthermore, we have reported that the process for governing such decisions should be clearly defined and

[32]For example, see Consolidated Appropriations Act, 2010, Pub. L. No. 111-117, div. C, title V, 123 Stat. 3034, 3200 (Dec. 10, 2009), which provides “that none of the funds provided in this Act shall be used to consolidate or close small rural and other small post offices in fiscal year 2010.”

[33]For example, see Pub. L. No. 111-117, which provides that “6-day delivery and rural delivery of mail shall continue at not less than the 1983 level.”

[34]Pub. L. No. 109-435, § 301.

[35]39 U.S.C. § 3661.

[36]Pub. L. No. 109-435, § 302.

[37]Remote Encoding Centers were established as a temporary solution to automate the processing of mail with handwritten addresses that could not be read by sorting equipment.

[38]United States Postal Service, Office of Inspector General, *Audit Report – Status Report on the Postal Service’s Network Rationalization Initiatives*, Report Number EN-AR-10-001 (Arlington, Va.: Jan. 7, 2010).

transparent, and include public notice and meaningful engagement with affected communities, mailers, and employees. In 2005, we recommended that USPS enhance transparency and strengthen accountability of realignment efforts to assure stakeholders that such efforts would be implemented fairly and achieve the desired results.[39] We have since testified that USPS took steps to address these recommendations and should be positioned for action.[40] Individual facility decisions are best made in the context of a comprehensive, integrated approach for optimizing the overall mail processing network. Key process issues in this area include how to better inform Congress and the public about the purpose and scope of USPS's optimization plans, address possible resistance to consolidating operations and closing facilities, and ensure that employees will be treated fairly.

Options in the mail processing area include the following:

- *Close major mail processing facilities:* The Postmaster General and other stakeholders have recently said that USPS could close many major mail processing facilities while maintaining current standards for timely delivery. Some stakeholders have estimated that roughly over one-half of these facilities are not needed.
- *Relax delivery standards to facilitate closures and consolidations:* USPS officials and experts have also noted that additional major processing facilities could be closed if delivery standards were relaxed. For example, one senior USPS official estimated that about 70 processing facilities could be eliminated if local First-Class Mail were to be delivered in 2 days instead of overnight.
- *Introduce a discount for destination-entry of First-Class Mail:*[41] Some mailers favor having USPS introduce a discount for entering First-Class

[39]GAO, *U.S. Postal Service: The Service's Strategy for Realigning Its Mail Processing Infrastructure Lacks Clarity, Criteria, and Accountability*, GAO-05-261 (Washington, D.C.: Apr. 8, 2005).

[40]GAO, *U.S. Postal Service: USPS Has Taken Steps to Strengthen Network Realignment Planning and Accountability and Improve Communication*, GAO-08-1022T (Washington, D.C.: July 24, 2008).

[41]PAEA defined "worksharing discounts" as reductions in postal rates that are provided to mailers for the presorting, prebarcoding, handling, or transportation of mail. Worksharing discounts are generally based on the costs that USPS is estimated to avoid as a result of mailer worksharing activities.

Mail at facilities that are generally closer to the mail's final destination. For mail sent to distant recipients, such destination entry would be expected to bypass some mail processing facilities and some USPS transportation. However, USPS officials told us that they did not believe that USPS could capture the potential cost savings from creating such a discount, because of existing excess capacity. If such a discount were to be applied to mail that is already locally entered—which comprises much First-Class Mail volume—that could reduce revenues with little corresponding cost savings.

Retail Operations

USPS's retail network has remained largely static, despite expanded use of retail alternatives and population shifts. USPS continues to provide service at about 36,500 post offices, branches, and stations and has not significantly downsized its retail operations in recent years. Furthermore, USPS has a maintenance backlog for its retail facilities.[42] USPS officials stated that maintenance has historically been underfunded, causing it to focus on "emergency" repairs at the expense of routine maintenance. USPS has limited its capital expenditures to help conserve cash, an action that may affect its ability to make progress on its maintenance backlog.

USPS recognizes the need to adjust its retail network to provide optimal service at the lowest possible cost and has expanded its use of alternatives to traditional post offices. In 2009, customers could also access postal services at more than 63,000 physical locations, such as purchasing stamps at drug stores and supermarkets. By fiscal year 2009, nearly 30 percent of retail transactions were conducted in locations other than USPS retail facilities. In addition, self-service options, such as Automated Postal Centers, are located in postal retail facilities. Opportunities to consolidate retail facilities are particularly evident in urban and suburban areas, where USPS retail locations are close to one another, customers have more options, and facilities are expensive to operate and maintain.

Some of the key issues in the retail area include whether USPS should retain its current retail network and find sources of revenue to support it other than through the sale of postal products, or whether it should eliminate unnecessary facilities, modernize its retail services, and partner with the private sector to provide services in other locations, such as shopping malls. Another issue is whether USPS should provide other

[42]GAO, *U.S. Postal Service Facilities: Improvements in Data Would Strengthen Maintenance and Alignment of Access to Retail Service*, GAO-08-41 (Washington, D.C.: Dec. 10, 2007).

governmental services in postal facilities and, if so, whether it would receive reimbursement.

Options in the retail area include the following:

- *Optimize USPS's retail facility network by expanding retail access and closing unneeded facilities:* In March 2010, USPS stated that it plans to expand customer access while reducing costs through new partnerships with retailers and other options, such as self-service kiosks. USPS explained that post offices are often less convenient for customers in terms of hours and accessibility, and cost two to three times more than alternatives. USPS also noted that it has more retail locations than McDonalds, Starbucks, Walgreens, and Walmart combined, but the average post office provides service to about 600 customers weekly—or about 1/10th in comparison to Walgreens. Additional postal retail locations could be located within drug stores, grocery stores, and other retail chain stores, such as those in shopping centers and local malls. These retail stores are often open 7 days a week, for longer hours than postal retail facilities. According to USPS officials, stores that could provide access to postal retail services pay their employees less than postal retail clerks who currently earn an average of over $40 per hour in compensation and benefits. USPS stated that it would reduce redundant retail facilities as customers continue to shift to alternatives, but noted that proposals to close facilities have led to protests and resistance. USPS called for Congress to eliminate the statutory prohibition on closing small post offices solely for operating at a loss,[43] and stated that changes would be needed to the regulatory review process for closing post offices. USPS also called for reduced constraints on the decision-making process for providing access to postal services. If USPS is not able to streamline its retail operations, it may need to make major reductions in the hours that post offices and retail facilities are open for window service.

- *Leverage the USPS retail network:* USPS could maintain current retail facilities and leverage this network by providing other nonpostal goods or services. Such activities might be performed by USPS or private-sector partners and other government agencies. For example, these partners and agencies could lease unused space in USPS facilities. Stakeholders suggested many options for diversifying into nonpostal retail areas, which could include selling nonpostal products at postal retail facilities and providing services for other federal, state, or local government agencies.

[43] 39 U.S.C. § 101(b).

While this option may increase the use of USPS's retail network, it may raise costs if facility modifications are needed, such as measures to maintain mail security at a facility where other business partners are colocated. Also, some competitors may raise concerns about USPS's legal advantages. For example, according to a 2007 report to Congress by FTC,[44] USPS is exempt from state and local taxes and fees and some other state and local statutes and regulations.

Delivery Operations

USPS has opportunities to reduce delivery costs, which is its most costly operation. More than 320,000 carriers account for close to one-half of USPS salary and benefit expenses. Because USPS delivers 6 days per week to most of its 150 million addresses, regardless of mail volume, it is difficult to reduce delivery costs commensurate with declining mail volume. In fiscal year 2000, carriers delivered an average of about 5 pieces of mail per day to every address, which fell to about 4 pieces in fiscal year 2009—a decline of 22 percent. This trend is continuing as mail volume declines and the delivery network continues to expand. Over 900,000 delivery points were added in fiscal year 2009—increasing costs by over $190 million, according to an USPS estimate.

In addition to the number of delivery points, the efficiency and cost of delivery operations depend on a variety of other factors, including the type of carrier route or the location of the receptacle where mail is delivered. For example, most customers (about 87 percent)[45] receive their mail via one of the three different types of carrier routes identified in table 7. These routes are served by carriers under different compensation systems, which largely account for the differences in their costs.

Table 7: Cost and Percentage of Delivery Routes, by Type, Fiscal Year 2009

Type of carrier route	Average annual national cost per address	Percentage of routes
City delivery	$198	64%
Rural delivery	156	32
Contract delivery	108	3

Source: USPS.

Note: Percentages do not add to 100 percent due to rounding.

[44]Federal Trade Commission, *Accounting for Laws that Apply Differently to the United States Postal Service and its Private Competitors* (Washington, D.C.: December 2007).

[45]The remaining 13 percent of addresses (about 20 million of the total 150 million delivery points) are to Post Office boxes. Most of these deliveries are served by clerks, not carriers.

Cost differences also exist related to the location of the mail receptacle (see table 8).

Table 8: Cost and Percentage of Carrier Deliveries, by Mode, Fiscal Year 2009

Mode of delivery	Average annual national cost per address	Percentage of carrier deliveries
Door[a]	$353	29%
Curbline	224	41
Centralized[b]	161	16
Collection/Cluster box units[c]	158	13

Source: USPS.

Note: Percentages do not add to 100 percent due to rounding.

[a]These deliveries are primarily door deliveries and also include "other" deliveries that are not covered by other categories.

[b]Centralized delivery is defined as delivery and collection services to a number of businesses or residences from a centrally located delivery point or place, such as a group of mailboxes at an apartment building.

[c]This category includes cluster box units (which are centralized units of individually locked compartments for the delivery of mail) and Neighborhood Delivery Collection Box Units (which are centralized units of more than eight individually locked compartments that receive mail).

We have reported on USPS's ongoing efforts to increase the efficiency of mail delivery.[46] USPS has begun to install 100 machines for its $1.5 billion Flats Sequencing System to sort flat-sized mail into delivery order. USPS expects this system to eliminate costly manual sorting, thereby improving delivery efficiency, accuracy, consistency, and timeliness. USPS is also realigning city carrier routes to remove excess capacity, which is expected to generate more than $1 billion in annual savings. This effort is expected to result in reduced facility space needs, increased employee satisfaction, and more consistent delivery service. Route realignment has been made possible by collaboration between USPS and the National Association of Letter Carriers and is continuing this fiscal year. In addition, USPS may have additional opportunities to further increase delivery route efficiency, such as by promoting the use of more efficient delivery modes for new delivery points.

Options in the delivery area include the following:

[46]GAO, *U.S. Postal Service: Mail Delivery Efficiency Has Improved, but Additional Actions Needed to Achieve Further Gains*, GAO-09-696 (Washington, D.C.: July 15, 2009).

- *Decrease delivery frequency from 6 days a week to 5 days a week:* USPS favors eliminating Saturday delivery to provide substantial financial savings.[47] According to USPS studies, its savings would be primarily achieved by eliminating work performed by city and rural letter carriers. Additional savings would be realized from reducing the use of delivery vehicles as well as reducing the scope of mail processing activities that support Saturday delivery. However, concerns have been raised about the impact on customers, who may need to wait longer to receive time-sensitive mail or go to USPS retail facilities to pick up mail; senders, who may have to change when they send mail; and USPS, which may lose the competitive advantage of delivering on Saturdays. According to USPS, eliminating Saturday delivery is estimated to result in annual savings of about $3 billion. PRC reported in 2009 that eliminating Saturday delivery would result in estimated annual savings of about $2.2 billion, on the basis of somewhat different assumptions regarding the likely effects on mail volume and costs. For this option to be implemented, Congress would need to exclude statutory restrictions that mandate 6-day delivery from USPS annual appropriations. USPS filed a request on March 30, 2010, for a PRC advisory opinion on its proposal to eliminate Saturday delivery, which would lead to a public proceeding that would include input by interested parties.

- *Allow USPS to determine delivery frequency on the basis of local mail volume:* A related option would be to change delivery frequency to match mail volumes to demand, which could change by season as well as by local area. For example, USPS could have less frequent delivery in low-volume summer months than the high-volume holiday season. Some residents already do not receive 6-day delivery, particularly those located in remote or seasonal vacation areas. A consequence of this option could be more frequent delivery to areas with higher mail volume, which could be in higher-income areas, which tend to receive much more mail. However, low-income residents and others, such as the elderly and disabled, may rely more on mail delivery. This option may also be criticized as inconsistent with current statutory requirements. USPS is required by law to provide prompt, reliable, and efficient services to patrons in all areas.[48] It is also required by law to provide a maximum degree of effective and

[47]USPS officials indicated that USPS would continue providing window retail service and delivery to Post Office boxes on Saturday as well as remittance mail service for business mailers.

[48]39 U.S.C. § 101(a).

regular postal services to rural areas, communities, and small towns where post offices are not self-sustaining.[49]

- *Expand the use of more cost-efficient modes of delivery for new addresses, including cluster boxes and curbline delivery:* USPS has recently estimated that this option could annually save around $2.5 billion by moving certain door deliveries to centralized deliveries. However, USPS officials told us that they and some mailers are concerned that this option would lead to residents picking up their mail less frequently, which could delay remittances and lower the value of advertising mail. It also would affect access to mail, particularly for customers who currently have mailboxes attached to their homes.

Streamline Field Structure

Further streamlining of USPS's field structure could help reduce facility and personnel costs. USPS has the authority to review the need for field administrative offices and streamline its field structure. For example, in fiscal year 2009, it closed 1 of its 9 area offices and 6 of its 80 district offices.

Options to Generate Revenues

USPS has many opportunities to generate additional net revenue, particularly from postal products and services; however, as it has noted, results from actions to generate revenue other than rate increases are likely to be limited compared with its expected losses. Aside from rate increases, USPS projects that it can increase profits by $2 billion by fiscal year 2020 through product and service initiatives. For example, according to USPS, it will work to increase direct mail use among small and medium-sized businesses and increase volumes in both First-Class Mail and advertising mail through targeted promotions. USPS also will continue to leverage its "last-mile" network to transport and deliver packages to their final destinations and work to grow other retail services, such as passport services provided by USPS and Post Office box rentals.

Key challenges in the area of revenue generation include the following:

- The short-term results will likely be limited by the economic climate as well as the ongoing diversion to electronic alternatives.

[49] 39 U.S.C. § 101(b).

- The potential for some actions will be limited because they will apply to mail or services that generate only a small fraction of revenues.

- USPS projects that its revenue will stagnate in the next decade despite further rate increases. Its revenue peaked at $75 billion in fiscal year 2007 but is projected to decline to $66 billion in fiscal year 2010, and to reach $69 billion in fiscal year 2020—growth that is below expected inflation.

Rate Increases for Market-Dominant and Competitive Products

Rate increases for market-dominant products, such as First-Class Mail and Standard Mail, would address pressing needs for revenue and could be used to better align rates and discounts with the costs, profitability, and price-sensitivity of mail. In the coming decade, rate increases for market-dominant products up to the price cap could raise significant revenues since these products currently generate 88 percent of revenue, while competitive products comprise nearly all other revenue.

Some key issues include the following:

- At what point are rate increases self-defeating, potentially triggering large, permanent declines in mail volume?

- How does USPS balance increasing rates to generate revenues with the impact on mailers and the long-term effects on volume, revenues, and the broader mailing industry?

- Would an "exigent" increase in postal rates over the price cap be justified, considering that it is limited by law to extraordinary or exceptional circumstances?

Some options include the following:

- *"Exigent" rate increases over the price cap:* USPS projects that its annual losses will increase greatly, even if rates for market-dominant products increase by the maximum allowed under the price cap. To improve its financial viability, USPS announced in March 2010 that it would seek "a moderate exigent price increase" for its market-dominant products that would be effective in 2011. An exigent rate increase over the price cap may produce a large short-term revenue boost. However, a very large rate increase could be self-defeating by increasing incentives for mailers to accelerate diversion to electronic alternatives, thereby lowering revenues in the long run and adding to USPS excess capacity. In 2009, USPS cited the potential impact on mail volume and the mailing industry when it ruled out an exigent rate increase for 2010—a year when the inflation-based price cap was zero—and announced that rates would not change for market-dominant products.

- *Rate increases for competitive products:* USPS annually increased rates in 2008, 2009, and 2010 for competitive products, including Priority Mail and Express Mail. Major USPS competitors, such as United Parcel Service (UPS) and FedEx, also have a history of annual rate increases.

Volume-Based Incentives for Specific Types of Market-Dominant Mail

USPS plans to pursue more volume-based rate incentives to stimulate additional mail use and take advantage of its excess capacity. For example, USPS reported that volume-based incentives can stimulate more advertising mail sent for sales, customer acquisition, and customer retention purposes, which should lead to greater mail use in the future. The additional mail volume can take advantage of USPS's large excess operational capacity. However, results to date suggest that such incentives can increase net income, but they appear to have limited potential compared with USPS losses. For example, a 2009 “summer sale” for Standard Mail that offered lower rates for volumes over mailer-specific thresholds reportedly had little effect on USPS's overall financial results for the fiscal year. USPS has estimated that about 38 percent of the volume qualifying for reduced “summer sale” rates would have been sent in the absence of the incentive, which reduced the profitability of this initiative. USPS plans to implement a similar initiative for summer 2010.

Some mailers have said that USPS should enter into more negotiated service agreements (NSA) with individual business mailers of market-dominant products. NSAs generally specify mutual agreements between USPS and mailers involving the preparation, presentation, acceptance, processing, transportation, and delivery of mailings under particular rate, classification, and service conditions, and restrictions that go beyond those required of other mailers. USPS did not generate net income from its seven NSAs in fiscal years 2007 through 2009 combined. These NSAs generally offered mailers lower rates for volumes that exceeded thresholds and had provisions to reduce some USPS costs, such as not returning undeliverable advertising mail and using electronic communications to provide this information to mailers. In comparison, USPS has negotiated about 100 contracts with business mailers of competitive products. Like NSAs for market-dominant products, contracts for competitive products are generally volume-based. These contracts also have provisions intended to lower USPS's mail-handling costs. PRC has reported that the contracts it approved in fiscal years 2008 and 2009 are expected to improve USPS's net revenue.

In December 2009, USPS officials told us that after PAEA was enacted, USPS preferred to pursue the volume-based incentive programs for market-dominant products that we have previously described, instead of pursuing NSAs. In theory, NSAs can increase net income by incentives tailored to each mailer's business needs, mailing practices, and opportunities to reduce USPS costs. In practice, it may be costly and time-consuming to negotiate NSAs and have them reviewed by PRC. The potential profitability of NSAs has been scrutinized in the past and is listed in PAEA as a factor for PRC to consider, along with (1) issues of fair competition, such as the availability of NSAs to similarly situated mailers, and (2) whether NSAs would cause unreasonable harm to the marketplace. These issues relate to the broader issue of whether USPS should have additional pricing flexibility and less PRC review of rates for its market-dominant products. USPS has suggested that regulatory and legal restrictions in this area need to be removed to provide greater flexibility, explaining that NSAs provide mailers with the opportunity to increase volume at a reasonable price.

Develop New Postal Products and Product Enhancements

During 2009, USPS considered options for developing new postal products and product enhancements, such as (1) "hybrid" mail that could be created online and printed and sent close to its final destination, which might involve USPS partnerships with private companies, and (2) new, low-cost ways for handling consumer electronics and other items that are being returned for recycling or disposal. As an example of recent product enhancements, USPS introduced new flat-rate boxes for Priority Mail, which it reports has met customer needs and generated volume growth. Consistent with USPS's stated strategy of providing greater value to its customers, some stakeholders told us that USPS should better understand and meet the needs and revenue growth opportunities of diverse mailers, in part through greater customer focus and improving the value of mail.

Increase Focus on Volume Growth in the Growing but Competitive Parcel Delivery Market

Competitive products are a promising growth opportunity for USPS, especially packages mailed by businesses to consumers. USPS forecasts that the volume of competitive products will increase 40 percent over the next decade. However, this volume growth is expected to have limited impact on losses, in part because competitive products generate only 12 percent of revenues. USPS is working to increase revenues from competitive products by increasing its market share in the growing package delivery market as well as by delivering more packages of competitors, such as "last-mile" delivery of packages that UPS or FedEx transport close to the destination and provide to USPS for final delivery. A key issue is what the net return would be if USPS pursues a growth strategy requiring costly additional investment to upgrade its automation and tracking capabilities in an area with formidable competitors.

Simplify Complex Rules for Mail Preparation and Entry

USPS may have opportunities to increase volume by reducing mailers' costs to prepare and enter mail as well as allowing more creative mail use for advertising and communications. However, this option could also risk additional costs to handle mail and provide assurance that discounted mail meets the necessary requirements. Some mailer groups and mailers have criticized USPS requirements that they consider to be impediments to volume and revenue growth. These stakeholders said that these requirements are costly for mailers but only yield marginal benefits for USPS, delay delivery, limit the effectiveness of mail, or are enforced in an overly stringent manner. USPS counters that (1) these requirements are needed to limit its handling costs and ensure that discounted mail meets the necessary requirements and (2) there are limited opportunities for it to increase revenues by simplifying its requirements. Some parties have said that USPS should strike a balance between requirements necessary for its operations and the need to provide mailers with flexible, low-cost methods to prepare and submit mail. USPS and mailers have long engaged in collaborative efforts to help define appropriate requirements. Redoubling efforts in this area could produce important benefits for USPS and the mailing industry.

New Nonpostal Products and Services

In 2009, USPS asked Congress to change the law so that it can diversify into nonpostal areas to find new opportunities for revenue growth, and some stakeholders have also supported diversification. USPS and stakeholders we collected information from offered many options for diversification into nonpostal areas, either on its own or in partnership with other private firms or government agencies. New nonpostal products and services that were identified include providing banking, financial, and insurance services; selling nonpostal products at its retail facilities; providing services for other federal, state, or local government agencies; carriers delivering nonpostal items or providing contract services (such as meter reading); advertising at USPS facilities; and providing electronic commerce. Diversification could involve entering new areas or earning revenues from business partners who sell nonpostal products at USPS retail facilities.

Whether USPS should be allowed to engage in nonpostal activities should be carefully considered, including its poor past performance in this area, as should the risks and fair competition issues. We have previously reported the following:

- USPS lost nearly $85 million in fiscal years 1995, 1996, and 1997 on 19 new products, including electronic commerce services, electronic money transfers, and a remittance processing business, among others.[50]

- In 2001, we reported that none of USPS's electronic commerce initiatives were profitable, and that USPS's management of these initiatives—such as an electronic bill payment service that was eventually discontinued—was fragmented, with inconsistent implementation and incomplete financial information.[51]

In enacting PAEA, Congress restricted USPS from engaging in new nonpostal activities. PAEA also required PRC to review USPS's existing nonpostal services to determine whether they should be continued or terminated. PRC recently found the intent of this requirement was to concentrate USPS's focus on its core responsibilities and away from nonpostal services that are not justified by a public need that cannot be met by the private sector. Allowing USPS to diversify into nonpostal activities would raise a number of issues, including whether it should engage in nonpostal areas where there are private-sector providers and, if so, under what terms. Other issues relate to concerns about unfair competition; whether USPS's mission and role as a government entity with a monopoly should be changed; as well as questions regarding how it would finance its nonpostal activities, what transparency and accountability provisions would apply; whether USPS would be subject to the same regulatory entities and regulations as its competitors; and whether any losses might be borne by postal ratepayers or the taxpayer.

USPS reported in March 2010 that even if it could enter nonpostal areas, such as banking or selling consumer goods, its opportunities would be limited by its high operating costs and the relatively light customer traffic of post offices compared with commercial retailers. USPS also stated that the possibility of building a sizable presence in logistics, banking, integrated marketing, and document management is currently not viable because of its net losses, high wage and benefit costs, and limited access to cash to support necessary investment. USPS concluded in its *Action*

[50]GAO, U.*S. Postal Service: Development and Inventory of New Products*, GAO/GGD-99-15 (Washington, D.C.: Nov. 24, 1998).

[51]GAO, *U.S. Postal Service: Update on E-Commerce Activities and Privacy Protections*, GAO-02-79 (Washington, D.C.: Dec. 21, 2001). Also see GAO, *U.S. Postal Service: Postal Activities and Laws Related to Electronic Commerce*, GAO/GGD-00-188 (Washington, D.C.: Sept. 7, 2000).

Plan that building a sizable business in any of these areas would require "time, resources, new capabilities (often with the support of acquisitions or partnerships) and profound alterations to the postal business model."

Options to Reform USPS's Statutory and Regulatory Framework

Addressing challenges to USPS's current business model may require restructuring its statutory and regulatory framework to reflect business and consumers changing use of the mail. While we do not address whether USPS's ownership structure should be modified in this report, many other statutory and regulatory considerations that should help to address the changing use of mail have been discussed and relate to the following elements of USPS's business model:

- *Mission:* What is an appropriate universal service obligation in light of fundamental changes in the use of mail?
- *Role:* Should USPS be solely responsible for providing universal postal service, or should that responsibility be shared with the private sector?
- *Monopoly:* Does USPS need a monopoly over delivery of certain types of letter mail and access to mail boxes to finance—in part or wholly—universal postal service?
- *Governance and regulation:* What is an appropriate balance between managerial flexibility and the oversight and accountability provided by the current governance and the regulatory structure?

USPS's Mission

USPS's statutory mission is to provide postal services to "bind the nation together through the personal, educational, literary, and business correspondence of the people."[52] It is required by law to provide prompt, reliable, and efficient services to patrons in all areas and postal services to all communities. These and related requirements are commonly referred to as the universal service obligation. PRC has reported that universal postal service has seven principal attributes (see table 9).

[52] 39 U.S.C. § 101(a).

Table 9: Attributes of the Universal Postal Service Obligation

Attribute	Description
Geographic scope	USPS is required to provide universal postal service throughout the nation and to and from foreign countries, subject to reasonable economic and efficiency limitations.
Range of products	The range of postal products included in the universal service obligation can change to meet the public's changing needs.
Access to universal services	Access takes into account not only the time and distance needed to get to a location where postal services are available, but also the time spent waiting to obtain services. "Essential postal services" include postal products, mail acceptance points such as collection boxes, access to letter carriers who accept mail for posting, and easily accessible information. Although USPS has discretion to determine the nature and location of postal facilities, these determinations are subject to statutory limitations, such as those related to closing post offices.
Delivery of universal services	Since fiscal year 1984, annual appropriations language has mandated that 6-day delivery continue at not less than the 1983 level.[a] However, USPS has discretion over the method used to deliver mail, such as to mailboxes attached to houses, curbside mailboxes, and cluster boxes.
Prices/Affordability	Requirements include reduced rate or no charge for some mail; uniform rate for at least one class of mail (currently First-Class Mail); and PAEA pricing constraints that include a price cap for market-dominant products.
Quality of service	USPS is required to provide quality postal service, and service changes that are nationwide or substantially nationwide in scope are subject to public comment and a PRC advisory opinion and must meet service quality standards.
Enforcement mechanism	Interested persons may file complaints with PRC for USPS's failure to meet certain statutory provisions, such as ratemaking requirements. If PRC finds a complaint to be justified, PRC is required to order USPS to take the appropriate action to come into compliance.

Source: Postal Regulatory Commission, *Report on Universal Postal Service and the Postal Monopoly* (Washington, D.C.: Dec. 19, 2008).

[a]Consolidated Appropriations Act, 2010, Pub. L. No. 111-117, div. C, tit. V, 123 Stat. 3034, 3200 (Dec. 16, 2009).

Key questions regarding universal postal service include the following:

- How much postal service does the nation need and how should it be funded?
- Should the costs of providing universal service be borne by postal ratepayers, or should taxpayers subsidize some unprofitable aspects of universal service that benefit the nation?
- If USPS cannot be financially viable without reducing universal postal service, what changes would be needed?
- Who should determine whether changes should be made to universal service (e.g., Congress, USPS, or PRC)?

In addition, issues have been raised about whether all postal products should be required to cover their costs, even if they provide social benefits, or receive a subsidy through appropriations. Historically, some types of mail were designed to channel broad public goals, such as furthering the dissemination of information, the distribution of merchandise, and the advancement of nonprofit organizations. For example, Periodicals (mainly, mailed magazines and newspapers) have historically been given favorable rates, consistent with the view that they help bind the nation together, but this class has not covered its costs for the past 13 fiscal years. Losses from Periodicals increased from $74 million in fiscal year 1997 to $438 million in fiscal year 2008 and to $642 million in fiscal year 2009. These escalating losses have provoked growing concern and controversy. Postal stakeholders are currently debating what corrective actions, if any, are warranted, and their possible impact on Periodicals.

Other money-losing types of mail with social benefits include the following:

- Single-piece Parcel Post was introduced in 1913 to provide affordable parcel delivery; this opened up the mail order merchandise market, especially in rural areas.
- Media Mail, or "book rate," as it was formerly known, was initially designed in 1938 to provide lower rates for mailed books and encourage the mailing of educational materials.
- Library Mail was introduced in 1928 as a preferential rate for books sent by or to libraries and was later expanded to schools, colleges, and universities in 1953.

According to a Congressional Research Service report, when Congress put USPS on a self-sustaining basis in 1971, it continued to subsidize the mailing costs of such groups as the blind, nonprofit organizations, local newspapers, and publishers of educational material, by providing an appropriation to cover the revenues that were given up, or "forgone," in charging below-cost rates to these groups.[53] Appropriations for these subsidies mounted as postage rates and the number of nonprofits grew, approaching $1 billion annually in the mid-1980s. Successive

[53]Congressional Research Service, *The Postal Revenue Forgone Appropriation: Overview and Current Issues*, RS21025 (Washington, D.C.: updated Sept. 21, 2006).

administrations sought to cut these costs by reducing eligibility and having other mailers bear more of the burden. Questions continue about how these money-losing types of mail should be funded.

All money-losing market-dominant products lost $1.7 billion collectively in fiscal year 2009, up from $1.1 billion in fiscal year 2008 (see table 10). In addition to the $642 million lost from Periodicals in fiscal year 2009, the largest money-losing product was Standard Mail Flats ($616 million).[54] Losses from Standard Mail Flats have nearly tripled over the past fiscal year. In its Annual Compliance Determination report for fiscal year 2009, PRC discussed actions that could be taken to deal with these and other money-losing products. Some of the losses from Standard Mail are due to unprofitable mail sent by nonprofit organizations. By law, rates for nonprofit Standard Mail are 60 percent of the rates for the most closely corresponding type of for-profit Standard Mail.[55] However, nonprofit rates benefit charitable and religious organizations, and Congress has long required preferential rates for nonprofit mail.

Table 10: USPS Money-Losing Market-Dominant Products, Fiscal Years 2008 and 2009

Dollars in millions

	Net income (loss)		
Market-dominant product	**Fiscal year 2008**	**Fiscal year 2009**	**Change**
Periodicals	$(438)	$(642)	**$(204)**
Standard Mail Flats[a]	(218)	(616)	**(398)**
Standard Mail (“not flat machinables”[b] and parcels)	(165)	(205)	**(39)**
Inbound single-piece First-Class Mail	(102)	(105)	**(3)**
Media and Library Mail	(58)	(74)	**(16)**
Single-piece Parcel Post	(64)	(61)	**3**
Other[c]	(37)	(23)	**14**
Total	**$(1,082)**	**$(1,726)**	**$(644)**

Sources: USPS and PRC.

Note: All data are rounded to the nearest million, including totals and changes between fiscal years.

[54]The Standard Mail Flats product includes some, but not all, flat-sized Standard Mail. This product does not include saturation advertising mail.

[55]39 U.S.C. § 3626(a)(6).

[a]Standard Mail Flats includes some, but not all, flat-sized Standard Mail. For example, saturation advertising mail is not part of the Standard Mail Flats product.

[b]Standard Mail "not flat machinables" include items that cannot be sorted by USPS automation equipment, such as CD jewel cases and other rigid items.

[c]Other includes ancillary services for international mail, Registered Mail, and Stamped Cards (losses in both fiscal years) as well as Bound Printed Matter, inbound surface Parcel Post at Universal Postal Union rates, Confirm Service, and address list services (losses in fiscal year 2009 only).

If Congress were to decide that all market-dominant products should cover their costs, it could also revisit other legal requirements that constrain USPS's pricing flexibility for these products. First, the price cap requirement may need to be revisited to enable some types of mail to be increased over the cap without resorting to the exigent rate increase process. For example, the average rate increase for the Periodicals class is limited to inflation under the price cap. Similarly, single-piece Parcel Post, Media Mail, and Library Mail are a significant part of the Package Services class that is also covered by the price cap. In addition, USPS could continue to gradually implement a rate structure for Periodicals that is based more on costs, which could involve rate increases for mail that is more costly to handle (e.g., mail provided to USPS in sacks, rather than on pallets). However, such a rate structure could disproportionately affect some small-circulation magazines.

Issues regarding which entity should consider and decide on changes to universal service—including Congress, PRC, or USPS—have long been debated. Because many aspects of universal service are required by law, Congress would have to make any changes in these areas. For example, Congress would have to redefine certain aspects of universal postal service that are required under current law, such as 6-day delivery, revised statutory preferences for nonprofit mail, and restrictions on closing small post offices. For some aspects of universal service, such as related pricing issues, PRC has the authority to act by establishing regulations that govern postal pricing and overseeing USPS compliance with legal requirements. USPS has flexibility to act on some other aspects, such as establishing and maintaining service standards for timely mail delivery.

USPS's Role

Another issue is whether postal services are an inherently governmental function, and whether USPS should be the only entity responsible for universal postal service. The federal government's responsibility for postal services is detailed in Title 39 of the *United States Code*. A possible rationale for sharing this responsibility would be to allow private companies to provide postal services, with the idea that competition could give some customers more choices that better meet their needs, through lower cost products and expanded services. A related consideration is that some aspects of postal service, particularly mail delivery, are considered to have economies of scale, meaning that, in theory, one provider might fulfill this function more economically than multiple providers. In practice, multiple providers—including USPS and numerous companies—already deliver mail (e.g., contractors who provide long-distance mail transportation and deliver mail to households located along sparsely populated highway routes).

Another question is whether USPS should continue to fulfill other roles, or whether these roles should be discharged by other agencies. For example whether USPS or some other law enforcement body should enforce postal laws was considered in the postal reform debate—specifically, whether the Postal Inspection Service that enforces mail fraud and other statutes should be transferred to another federal law enforcement agency. Another example is USPS's involvement in responding to national disasters, including hurricanes and terrorist attacks. In this regard, a recent executive order stated that USPS has the capacity for rapid residential delivery of medical countermeasures across all U.S. communities, and that the federal government will use USPS to implement national medical countermeasures in the event of a large-scale biological attack.[56]

USPS Monopoly

USPS has two types of monopolies to (1) deliver certain letter mail and (2) have exclusive access to mailboxes.

The Mail Monopoly

USPS has a monopoly over the delivery of certain letter mail to help ensure that it has sufficient revenues to carry out public service mandates, including universal service.[57] USPS has promulgated regulations to identify exceptions to the postal monopoly.[58] Some key exceptions include "extremely urgent" letters (generally, next-day delivery) and outbound international letters. Most mail volume is covered by this monopoly,

[56]Exec. Order No. 13527, *Establishing Federal Capability for the Timely Provision of Medical Countermeasures Following a Biological Attack*, 75 Fed. Reg. 737 (Dec. 30, 2009).

[57]The basic restrictions on private delivery of letter mail are in seven sections of the federal criminal statutes (18 U.S.C. §§ 1693-1699) as well as additional provisions dealing with private delivery of letters (39 U.S.C. §§ 601-606). These laws generally prohibit anyone from establishing, operating, or using a private company to carry letters for compensation on regular trips or at stated periods over postal routes or between places where U.S. mail regularly is carried. Violators are subject to fines or, in some cases, imprisonment.

[58]See, for example, 39 C.F.R. § 320.6.

regulated as market-dominant mail, and subject to the price cap. Over the years, Congress has reevaluated the need for the mail monopoly, broadening and reducing it at various times, including in PAEA.[59]

For over 200 years, USPS and its predecessor, the former U.S. Post Office Department, operated with a statutory mail monopoly, which restricted the private delivery of most letters. Congress created the mail monopoly as a revenue protection measure to help enable the former Post Office Department to fulfill its mission. A rationale for the mail monopoly is to prevent private competitors from engaging in an activity known as cream-skimming, that is, offering service on low-cost routes at prices below those of USPS, while leaving USPS with high-cost routes. Furthermore, allowing private companies to compete for mail now covered by the monopoly could lead to additional declines in mail volume and revenue, thereby increasing excess capacity and reducing USPS's net income.

According to PRC, the most frequent argument against the mail monopoly is that, assuming a legal framework continues to exist to protect public interest and the provision of universal service, competitive markets might produce more efficient, innovative, flexible, and fairer services to buyers and producers. Narrowing or eliminating the monopoly could increase consumer choice and provide incentives for USPS to become more effective and efficient. Critics of the monopoly also cite the experience of foreign countries that have narrowed, eliminated, or are phasing out their monopolies.

The Mailbox Monopoly

This restriction prohibits anyone from knowingly and willingly placing mailable matter without postage into any mailbox.[60] As we have reported, the purposes of the restriction, which dates back to 1934, were twofold—to stop the loss of postal revenue resulting largely from private messengers delivering customer bills to mailboxes without paying postage and to decrease the quantity of extraneous matter being placed in mailboxes.[61] PAEA did not change the mailbox monopoly.

[59]Pub. L. No. 109-435, § 503.

[60]18 U.S.C. § 1725.

[61]GAO, *Postal Service Reform: Issues Relevant to Changing Restrictions on Private Letter Delivery*, GAO/GGD-96-129B (Washington, D.C.: Sept. 12, 1996).

USPS has stated that continuation of the mailbox monopoly would best preserve customer service, safety, security, and the value of mail. According to USPS, the mailbox monopoly helps deter mail theft and identity theft, facilitates enforcement when violations occur, and is needed for efficient mail collection and delivery. We have previously reported that critics of the mailbox monopoly said it impedes competition and infringes on private property.[62] FTC reported in 2007 that the mailbox monopoly reduces competition and raised competitors' costs of delivering products that otherwise could fit into a mailbox.[63] While FTC recognized mail security and privacy issues, it concluded that Congress and PRC may want to consider whether relaxing the mailbox monopoly to allow consumers to choose to have private carriers deliver competitive products to their mailboxes would create net benefits. In 2008, PRC stated that it "does not recommend any changes to the mailbox rule," citing issues with mail security and USPS efficiency. PRC also noted that its public proceeding evidenced broad support for continuing the mailbox monopoly.

Governance and Regulation

The effectiveness of USPS's governance and regulatory structure is critical to its success and to ensuring that quality affordable postal services are provided to the American people. The 2003 President's Commission noted that managerial accountability must come from the top, with USPS being governed by a strong corporate-style board that holds its officers accountable. The commission concluded that giving USPS greater flexibility would require enhanced oversight by an independent regulatory body endowed with broad authority, adequate resources, and clear direction to protect the public interest and ensure that USPS fulfills its duties. A number of regulatory changes were implemented after PAEA was enacted, and a thorough review of these changes has not been developed. PAEA required PRC to submit a report to Congress by December 2011 concerning "the operation of the amendments made by [PAEA]" and any recommendations for improvements to the U.S. postal laws. Another PRC report is required by December 2016 to determine whether the system for regulating rates and classes for market-dominant products is achieving its objectives.

[62]GAO, *U.S. Postal Service: Information About Restrictions on Mailbox Access*, GAO/GGD-97-85 (Washington, D.C.: May 30, 1997).

[63]*Accounting for Laws that Apply Differently.*

Governance

The Board of Governors directs the exercise of the powers of USPS, directs and controls its expenditures, reviews its practices, and conducts long-range planning. The board sets policy; participates in establishing postage rates; and takes up various matters, such as mail delivery standards and some capital investments and facilities projects. By law, governors are chosen to represent the public interest and cannot be "representatives of specific interests using the Postal Service."[64] Despite the changes made by PAEA, the qualifications of USPS governors continue to be an issue. Members of the Board of Governors told us that the board lacks sufficient business and financial expertise. The members also suggested that some governors should not be politically appointed. In this regard, the 2003 President's Commission recommended that the Board of Governors be comprised of 12 individuals: 3 presidential appointees, 8 independent members selected by the 3 appointees with the concurrence of the Secretary of the Treasury, and the Postmaster General (who would be selected by the other 11 members).[65]

Regulation

Should any of the operational or structural options outlined in this report be implemented, Congress, USPS, the Board of Governors, PRC, and other relevant postal stakeholders could consider whether governance and regulatory structures need to be changed to reflect an appropriate balance in the oversight roles of these entities. PAEA gave USPS more pricing and product flexibility, which was balanced by strengthening PRC's oversight authority. Among other things, PAEA required PRC to develop the regulatory structure for postal rates, consult with USPS on establishing delivery service standards, and annually determine USPS's compliance with applicable laws. Also under PAEA, PRC was granted the authority to issue subpoenas; direct USPS to adjust rates not in compliance with applicable postal laws; or, in cases of deliberate noncompliance with applicable postal laws, levy fines.

[64] 39 U.S.C. § 202(a).

[65] Successors to the 8 independent members would be selected by the full board, with the concurrence of the Secretary of the Treasury.

Actions Congress and USPS Can Take to Facilitate Progress toward Financial Viability

Action by Congress and USPS is urgently needed on a number of difficult issues to facilitate progress toward USPS's financial viability by reducing costs, increasing efficiency, and generating revenues. The significant deterioration in USPS's financial condition over the past 2 years, its increasing debt, and the grim forecast for declining volume over the next decade led GAO to add USPS's financial condition to its high-risk list in July 2009. We suggested that USPS develop and implement a broad restructuring plan, with input from PRC and other stakeholders, to identify specific actions planned, key issues, and steps Congress and other stakeholders need to take. On March 2, 2010, USPS issued its *Action Plan*, which identified seven key areas wherein it would need legislative changes or support. Many of the options discussed are also options we have analyzed and included in this report for consideration. USPS forecasts of mail volume, revenue, and net income over the next decade quantify the magnitude of the challenges that it faces from continued volume decline to about 150 billion pieces in fiscal year 2020—about the same as the volume level in fiscal year 1986—and a projected cumulative $238 billion shortfall if no additional efficiency or revenue initiatives are undertaken. USPS's *Action Plan* indicates that actions within its control can close $123 billion of this financial gap, but that actions outside its existing authority—including some involving statutory changes—would be needed to eliminate the remaining financial gap. Action on these issues will likely take several years to fully implement once a decision is made on the scope of needed changes. Therefore, agreement on next steps is urgently needed.

If USPS is to continue being self-financing, Congress, USPS, and other stakeholders will need to reach agreement on major issues that impede its ability to implement actions to reduce losses. These issues include funding postal retiree health benefits; reexamining binding arbitration; realigning services, operations, networks, and workforce to reflect declining volume; and changing use of the mail in a dynamic marketplace as well as generating revenue.

- *Funding postal retiree health benefits:* USPS has said that it cannot afford its required prefunding payments on the basis of its significant volume and revenue declines, incurring large losses, nearing its debt limit, and limited cost-cutting opportunities under its current authority. Several proposals have been made to defer costs by revising the statutory requirements, and it is important that USPS fund its retiree health benefit obligations—including prefunding these obligations—to the maximum extent that its finances permit. In addition to considering what is affordable and a fair balance of payments between current and future ratepayers, Congress would also have to address the impact of these proposals on the federal budget. CBO has raised concerns about how aggressive cost-cutting measures would be if prefunding payments for retiree health care were reduced. This concern further indicates the need for broad agreement on specific realignment actions, the time frame for implementation, and the expected financial impact.

- *Binding arbitration:* One of the most difficult challenges USPS faces is making changes to its compensation systems, which will be critical to its financial condition since wages and benefits comprise 80 percent of its costs. In this regard, the time has come to reexamine the structure for collective bargaining that was developed 40 years ago. Since that time, the competitive environment has changed dramatically and rising personnel costs are contributing to escalating losses. Thus, it is imperative to ensure that USPS's financial condition be considered in upcoming collective bargaining if the process reaches binding arbitration.

- *Realigning postal services with changing use of the mail:* As mail use by businesses and consumers continues to change, USPS has stated that it cannot afford to provide the same level of services and that changes are needed. USPS has estimated that it could reduce costs by about $3 billion annually if it could reduce delivery frequency from 6 days to 5 days, but congressional agreement would be needed to not include a 6-day delivery requirement in USPS annual appropriations. USPS filed a request on March 30, 2010, for a PRC advisory opinion on its proposal to eliminate Saturday delivery.

- *Generating revenue through new or enhanced product and services:* On the revenue side, a key issue is whether USPS can make sufficient progress using the pricing and product flexibility provided in PAEA or whether changes may be needed. The *Action Plan* stated that USPS needs additional authority to adjust its pricing to better reflect market dynamics and proposed some changes. These proposals have not been fully analyzed, nor have PRC and stakeholders had an opportunity to provide input. Thus, it is unclear what statutory or regulatory changes should be made at this time. Another key issue is whether USPS should be allowed to engage in new nonpostal areas that may compete with private firms. Congress considered many of the public policy issues in this area related to fair competition prior to PAEA's enactment in 2006 and decided at that time not to let USPS engage in new nonpostal areas. It is not clear what specific actions USPS would like to take, their expected profitability, or how they might affect other businesses. USPS's current financial condition may limit its expansion into other areas in the short term, but ultimately its plans in this area could affect its operations.

- *Realigning operations, networks, and workforce:* Once Congress and USPS have determined what, if any, changes should be made in the products and services that it provides, corresponding changes will be needed in postal operations, networks, and workforce. This area involves some public policy issues that Congress may want to address. USPS will need to address detailed operational issues related to increasing cost-efficiency. Some of the difficult tradeoffs in this area include USPS's need to significantly reduce its size to remain self-financing and keep prices affordable, versus concerns about whether such reductions could harm the value of its brand, its network of physical assets, and the social benefits that it provides as well as the effects of these actions on its workforce.

  USPS has made limited progress in optimizing its networks over the last decade, particularly in facilities that include public access to retail operations. For example, in July 2009, USPS initiated a PRC review of over 3,600 retail stations and branches located primarily in urban and suburban areas for possible consolidation or discontinuance, but fewer than 200 facilities remain under consideration for such actions. PRC issued its advisory opinion on USPS's proposed retail consolidations in early March, which affirmed USPS's authority to adjust its retail network while recommending several process improvements.[66] Considering the numerous statutory and regulatory requirements in this area, it could be difficult to make rapid changes to rightsize its network of 36,500 retail facilities. USPS's *Action Plan* says that it plans to expand access to retail service and, as customers shift to these new services, that it will reduce redundant retail facilities. However, it is unclear what specific changes would be made, how long it would take to make these changes, and how much annual cost savings could be achieved. USPS's *Action Plan* also does not address possible closures of large mail processing facilities to reduce the excess capacity in its mail processing network.

  A new approach is urgently needed to make the necessary progress in realigning postal operations and networks as USPS's core business continues to decline. Conducting business as usual is unlikely to produce significant results, particularly in the rapid time frame that would be required to avert massive losses. Thus, it will be important for Congress, USPS, and other stakeholders to reach agreement on the package of

[66]Postal Regulatory Commission, *Advisory Opinion Concerning the Process for Evaluating Closing Stations and Branches*, Docket No. N2009-1 (Washington, D.C.: Mar. 10, 2010).

actions that should be taken, the desired operational and financial results, and the time frames for implementation. Key questions that need to be addressed include the following:

- *Universal service issues:* What, if any, changes are needed—that is, should delivery services be changed (e.g., frequency or standards), and should USPS continue moving retail services out of post offices to alternative locations?
- *New products and services:* What opportunities are there to introduce profitable new postal products and enhancements to existing ones? Should USPS engage in nonpostal areas where there are private-sector providers? If so, under what terms?
- *Realigning operations, networks, and workforce:* How should USPS optimize its operations, networks, and workforce to support changes in services; how quickly can this happen; and how can it work with its employees and customers to minimize potential disruption?

This is an area where Congress may want to consider an approach similar to that used by the Department of Defense's Base Realignment and Closure (BRAC) Commission, which was established to realign military installations within the United States. Under the Defense Base Closure and Realignment Act of 1990, the President can either accept or reject BRAC recommendations in their entirety.[67] If rejected, the BRAC Commission could give the President a revised list of recommendations. If the President accepts the list of recommendations, it is forwarded to Congress and the list becomes final, unless Congress enacts a joint resolution. Our report on the 2005 BRAC round noted that the Department of Defense viewed this BRAC as a unique opportunity to reshape its installations and realign its forces to meet its needs for the next 20 years.[68]

Congress has previously turned to panels of independent experts to assist in restructuring organizations that are facing key financial challenges. These panels have gained consensus and developed proposed legislative or other changes to address difficult public policy issues. For example, the District of Columbia Financial Responsibility and Management Assistance

[67] Pub. L. No. 101-510, § 2901, 104 Stat. 1485, 1808 (Nov. 5, 1990).

[68] GAO, *Military Base Realignments and Closures: Cost Estimates Have Increased and Are Likely to Continue to Evolve*, GAO-08-159 (Washington, D.C.: Dec. 11, 2007).

Authority was established to, among other things, (1) eliminate budget deficits and cash shortages of the District through financial planning, sound budgeting, accurate revenue forecasts, and careful spending; (2) ensure the most efficient and effective delivery of services, including public safety services, by the District during a period of fiscal emergency; and (3) conduct necessary investigations and studies. This organization was suspended in 2001 once relevant legal provisions were met, including achieving a balanced budget for a 4th consecutive year.

Establishing a similar commission or control board of independent experts could provide a mechanism to assist Congress in making timely decisions and comprehensive changes to USPS's business model and operations. A commission of experts may be more appropriate to facilitate the changes needed to achieve financial viability while also considering stakeholder interests. The following questions could assist Congress in developing such a commission:

- What criteria should be used to select commission members, for example, logistics experience, business restructuring, or labor management expertise?
- How could the commission best ensure that diverse stakeholder interests are appropriately considered?
- What would be the time frame of the commission?
- What goals or objectives should guide the commission—for example, ensuring USPS's financial viability, and recommending policy and management changes?

Conclusions

USPS faces daunting financial losses that it projects could total over $238 billion through fiscal year 2020, unless it can substantially reduce its costs, including the size of its operations, networks, and workforce to reflect declining mail volume, and to generate new revenues. USPS's planned actions under its existing authority will not be enough to make it financially viable. Therefore, Congress, USPS, and other stakeholders need to reach agreement on a package of actions to take so that USPS can become financially viable. This agreement will need to address difficult constraints and legal restrictions that continue to hamper progress. Such an agreement is urgently needed so that Congress and stakeholders have confidence that the actions USPS takes will be fair to all stakeholders. Then USPS could begin to plan and make the necessary changes, some of which may require several years to fully implement and realize potential cost savings. For example, restructuring operations and networks would require coordinated actions involving postal employees, mailers, and the public.

To reach agreement on these difficult issues, Congress could engage a panel of independent experts to develop a credible and comprehensive package of specific proposals, including the following:

- Potential changes related to adapting universal postal services to the declining use of mail, such as removing the statutory requirements for 6-day delivery and restrictions on closing post offices.

- Changes needed to realign USPS operations, networks, and workforce with its declining workload, and how to address employee and community concerns and resistance to facility closures.

- Improving opportunities to generate revenues, and whether that should include allowing USPS to engage in new nonpostal areas.

Due to the urgency of USPS's deteriorated financial condition and outlook, and the fact that it is rapidly approaching its statutory debt limit, Congress may need to provide financial relief, for example, by revising the funding schedule for retiree health benefits. Another action that Congress could take in the near term, which would have a longer-term impact, would be to modify the collective bargaining process to ensure that any binding arbitration would take USPS's financial condition into account. Furthermore, Congress may want assurance through regular reports that any financial relief it provides is met with aggressive actions to reduce costs and increase revenues, and that progress is being made toward addressing its financial problems.

Ultimately, Congress may want to consider changing USPS's ownership structure, but the resolution of these more pressing issues might afford a better understanding of whether the ownership structure should be modified. As communications and the use of the mail evolve, Congress will need to revisit policy issues related to USPS, the services it provides, and how to best position the organization for the future. The current crisis presents the opportunity to act and position this important American institution for the future. If no action is taken, the risk of USPS's insolvency and the need for a bailout by taxpayers and the U.S. Treasury increases.

Matters for Congressional Consideration

To address USPS's financial viability in the short term, Congress should consider providing financial relief to USPS, including modifying its retiree health benefit cost structure in a fiscally responsible manner. Congress should also consider any and all options available to reduce USPS costs, including revising the statutory framework for collective bargaining to ensure that binding arbitration takes its financial condition into account. At the same time, to facilitate making progress in difficult areas, Congress should consider establishing (1) a panel of independent experts, similar to a BRAC-like commission, to coordinate with USPS and stakeholders to develop a package of proposed legislative and operational changes needed to reduce costs and address challenges to USPS's business model and (2) procedures for the review and approval of these proposals by the President and Congress. These proposals could focus on adapting delivery and retail services to declining mail volumes; making postal operations, networks, and workforce more cost-efficient; and generating new revenue.

Congress also should consider requiring USPS to provide regular reports to Congress to ensure that USPS is making progress to improve its financial condition. These reports could include the actions taken to reduce costs and increase revenues, the results of these actions, and progress toward addressing financial problems.

Agency Comments and Our Evaluation

USPS provided written comments on a draft of this report by a letter dated April 2, 2010. These comments are summarized below and included in their entirety in appendix II of this report. In separate correspondence, USPS also provided technical comments, which we incorporated as appropriate.

USPS stated that it agreed with many key points in our report and with all but one of our matters for congressional consideration. First, regarding revising USPS retiree health benefit funding, USPS said the prefunding requirement urgently needs to be restructured and agreed that it should continue to fund its retiree health benefits obligation to the maximum extent that its finances permit. Second, USPS agreed that Congress should consider revising the statutory framework for USPS collective bargaining to ensure that binding arbitration takes its financial condition into account. Third, USPS agreed that Congress should consider requiring USPS to provide regular reports to ensure that it is making progress to improve its financial condition. However, USPS raised concerns about using a panel of independent experts to develop a package of proposed legislative and other changes, stating that doing so would add a layer of bureaucracy and delay to problems that require immediate attention. We believe that unless Congress and USPS agree on actions to be taken, USPS will not be able to reduce costs enough to close the revenue gap and achieve financial stability. Congress has used such panels to successfully reach agreement regarding other difficult restructuring issues.

We are sending copies of this report to the appropriate congressional committees, the Postmaster General, the Chairman of the USPS Board of Governors, the Chairman of the Postal Regulatory Commission, and other interested parties. In addition, the report will be available at no charge on GAO's Web site at http://www.gao.gov.

If you or your staffs have any questions regarding this report, please contact me at (202) 512-2834 or herrp@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in appendix III.

Phillip Herr
Director, Physical Infrastructure Issues

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The Honorable Susan M. Collins
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United States Senate

The Honorable Thomas R. Carper
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The Honorable José E. Serrano
Chairman
The Honorable Jo Ann Emerson
Ranking Member
Subcommittee on Financial Services and
General Government
Committee on Appropriations
House of Representatives

Appendix I: Objectives, Scope, and Methodology

The Postal Accountability and Enhancement Act (PAEA) of 2006 required us to report on strategies and options for the long-term structural and operational reform of the United States Postal Service (USPS). Because of USPS's financial crisis and our assessment that restructuring is urgently needed, our work has been accelerated at the request of Members of Congress and is presented in this report. The objectives of this report are to assess (1) the viability of USPS's business model, (2) strategies and options to address challenges to USPS's current business model, and (3) actions Congress and USPS need to take to facilitate progress toward USPS's financial viability.

To assess the viability of USPS's business model, we relied on our past work, including putting USPS's financial condition on GAO's high-risk list in July 2009, and on our testimonies regarding its deteriorating financial condition. We interviewed multiple USPS officials, including the Postmaster General, the Deputy Postmaster General, the former and current Chairman of the Board of Governors, and headquarters and field staff during visits to post offices, mail processing facilities, and other facilities that serve urban and rural areas. We reviewed USPS financial and operating information, including its Annual Reports, Integrated Financial Plans, and Comprehensive Statements; other strategic documents, including its transformation plans, *Assessment of U.S. Postal Service Future Business Model*, action plan released March 2010—entitled *Ensuring a Viable Postal Service for America: An Action Plan for the Future* (*Action Plan*)—and the *Action Plan's* financial and volume projections; and collective bargaining agreements. We reviewed USPS's current legal and regulatory framework and relevant congressional testimonies and hearings. We also reviewed the results of retiree health valuations provided to us by the Office of Personnel Management (OPM) in March 2010. OPM's valuations, which include estimates of future obligations, costs, premium payments, and fund balances, were based on USPS employee population projections. We did not assess the reasonableness of USPS's population projections or OPM's actuarial assumptions and methodology. We utilized OPM's valuation results to analyze the financial impacts of selected options for funding USPS's retiree health benefit obligations. We did not assess the validity of USPS's financial and mail volume projections due to time and resource constraints.

Also, we examined reports issued by other postal stakeholders, including the Postal Regulatory Commission (PRC) (particularly its 2008 report on *Universal Postal Service and the Postal Monopoly*), USPS Office of Inspector General, Congressional Research Service, Congressional Budget Office, the 2003 President's Commission on the United States Postal Service, and other mailing industry experts. We also met with PRC commissioners and various staff members; representatives of the four major employee unions and three major management associations (the American Postal Workers Union, National Association of Letter Carriers, National Postal Mail Handlers Union, National Rural Letter Carriers' Association, National Association of Postmasters of the United States, National League of Postmasters, and National Association of Postal Supervisors); USPS Office of Inspector General; Military Postal Service Agency; members of the mailing industry; other postal stakeholders; and economists.

To identify options to address the challenges in the current business model, we reviewed information from many of the sources that we have previously mentioned, including (1) past GAO work, (2) relevant congressional hearings and testimonies, (3) stakeholder studies, and (4) interviews with stakeholders. We then supplemented this information by distributing a list of questions to over 60 organizations to gather their opinions on actions that could be taken to improve USPS's business model and the potential impacts of these actions. Organizations were selected on the basis of a variety of factors, including those who have testified before Congress on postal issues; submitted comments (1) during the public comment solicitations as part of the work of the 2003 President's Commission on the United States Postal Service, (2) to PRC on universal service, the postal monopoly, and the new regulatory structure for ratemaking, and (3) to the Federal Trade Commission on differences in the legal status between USPS and its competitors; and have been active participants in various USPS-related activities, including participation in the Mailers' Technical Advisory Committee (a joint USPS-industry workgroup). We also considered the nature of the organization and selected organizations that represented various sections of the postal community, including unions, management associations, private printing and mailing companies, and mailers across various mail segments (e.g., large and smaller mailers, First-Class Mail, Standard Mail, Periodicals, parcels, newspapers, and nonprofit mail). We received responses from 24 mailing associations, 15 private companies, and 4 postal unions and management associations, which is a response rate of about 70 percent.

We then gathered and evaluated relevant options on the basis of a variety of criteria, including their potential to reduce USPS costs, realign its operations, and increase revenues, in light of its current and projected financial condition. Some options are consistent with actions we have discussed in our past work—such as optimizing USPS's retail, delivery, and mail processing networks—while others have been discussed in congressional hearings, regulatory proceedings, and major studies. Other options, some of which would require significant changes to USPS's legal framework or to current collective bargaining agreements, were selected because they would provide useful context into the key restructuring issues that we have previously described in this report. We did not include every option that we had identified in this report; rather, we present a select listing of options that were based on these criteria. We analyzed each option on the previously mentioned criteria; reviewed available cost and revenue data; and considered potential impacts on various stakeholders, including USPS, employees, mailers, and the public.

For reporting purposes, we grouped options according to these following strategies to align costs with revenues

- reducing compensation and benefits costs;
- reducing other operations and network costs and improving efficiency; and
- generating revenues through product and pricing flexibility.

Our assessment of certain options related to USPS's business model, such as in the governance and regulatory areas, was also limited because it is still too soon to see the full impact of the changes from PAEA. Furthermore, we did not address whether USPS's ownership structure should be altered at this time, but focused instead on the more pressing issues discussed throughout the report. The resolution of these operational issues may afford a clearer understanding of whether USPS's ownership structure should be modified. We also plan to address the experiences of foreign postal administrations in a separate report.

The previously mentioned analysis that we performed was also used as a basis to determine actions that Congress and USPS need to take facilitate progress toward USPS's financial viability. We supplemented this analysis with other GAO work on independent commissions and control boards, including the Department of Defense's Base Realignment and Closure Commission, and the District of Columbia Financial Responsibility and Management Assistance Authority.

We conducted this performance audit from August 2009 to April 2010 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings based on our audit objectives.

Appendix II: Comments from the United States Postal Service

JOHN E. POTTER
POSTMASTER GENERAL, CEO

UNITED STATES POSTAL SERVICE

April 2, 2010

Mr. Phillip R. Herr
Director, Physical Infrastructure Issues
United States Government Accountability Office
441 G Street, NW
Washington, DC 20548-0002

Dear Mr. Herr:

Thank you for the opportunity to comment on the draft report titled *U.S. Postal Service: Strategies and Options to Facilitate Progress toward Financial Viability* (GAO-10-455). I appreciate the time and effort the Government Accountability Office (GAO) has devoted to these complex issues.

I am pleased that many of the actions set out in the Postal Service's plan also appear in this GAO report, and that we are in agreement on many key points. There is no question that the Postal Service's business model is not viable and that swift action must be taken to avert a financial crisis. Studies have been done, reports generated, polls taken, and projections made and analyzed. The drivers of revenue decline and cost growth are clear. There is no reason to believe that this situation will improve without structural changes.

Eight months have passed since the GAO added the Postal Service to its list of high-risk federal government programs, saying "…the Postal Service needs a restructuring plan to adjust services to meet changes in the way customers use the mail, bring personnel and other costs into better alignment with revenues, and retain earnings to cover capital investments and debt repayment." The current GAO report presents an even-handed, detailed assessment of the Postal Service's continuing challenges.

On March 2, 2010, the Postal Service laid out a practical, actionable, customer-focused plan—one consistent with the GAO's assessment—to close the gap between costs and revenue. The actions and structural changes proposed in the plan seek to make it possible for the Postal Service to continue providing the United States with reliable, affordable, high-quality service, rapidly adjust its business to reflect changing market conditions, and finance the universal service obligation. Some of these actions can be taken under our existing authority. However, the Postal Service cannot achieve solvency using only the authority it has today.

Both the GAO's high-risk assessment and the current report note that the Postal Service must be able to retain earnings to cover capital investments and debt repayment, in addition to funding its existing obligations. The Postal Service completely agrees, and is committed to a solution that provides sufficient liquidity. If a proposed course of action does not provide sufficient liquidity, it is not a viable solution.

The report sets out three matters for Congressional consideration on certain issues and provides a number of related options. We discuss these matters below.

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1. *Congress should consider providing financial relief, such as revising USPS retiree health benefits funding and requiring any binding arbitration to take USPS' financial condition into account.*

The Postal Service urgently needs a restructuring of the prefunding requirement, which would ease financial pressures while we work to execute additional strategies to reduce costs, grow revenue, and increase efficiencies. Legislative action on the payment schedule would also reduce our need to borrow from the Treasury for the sole purpose of depositing money back into the Treasury for the Retiree Health Benefits Trust Fund.

The report says "USPS should continue to fund its retiree health benefit obligations to the maximum extent that its finances permit." I share that view, and the Postal Service will continue to do everything it can within the current law to regain its financial health. However, the existing business model provides neither the financial resources nor the flexibility to meet the payment schedule in current law. This was amply illustrated in FY 2009, when despite having achieved $6.1 billion in savings and obtaining financial relief from Congress, the Postal Service still ended the year with a $3.8 billion loss.

As important as it is, restructuring of retiree health benefits funding alone is not enough to ensure the Postal Service's short- and long-term financial health. We urge Congress to review potential overpayments to the Postal Service's CSRS pension fund. We support the recommendation of the USPS Office of Inspector General to divide legacy costs in a far more equitable manner than the current system.

In addition, we strongly agree with the GAO report that Congress should consider requiring arbitrators to take the Postal Service's financial condition in making any arbitration award.

2. *Congress should consider setting up a panel of experts to develop proposals for legislative and operational changes*

The GAO report also proposes for consideration the creation of a panel composed of independent experts to work with the Postal Service and stakeholders to provide Congress with a package of proposed legislative and other changes that would focus on allowing the Postal Service to adapt delivery and retail services to declining mail volumes; make its operations, networks and workforce more efficient, and generate new revenue.

We have concerns about this proposal. We believe that it would add a layer of bureaucracy and delay to problems that require immediate attention. Our challenges are urgent and well documented. It is time to act. While a BRAC-type model was effective in managing a limited number of military installations nationwide, it would not be as useful in dealing with postal operations and services found in every community in the country.

3. *Congress should require the Postal Service to provide regular reports on its actions and progress toward financial viability*

The GAO report suggests that Congress consider requiring us to provide regular reports on the actions taken to reduce costs and increase revenues, the results of these actions, and the progress toward addressing its financial problems. We agree, and plan to ensure transparency and accountability through a number of regular reports we currently are required to file. These include quarterly and annual SEC-like reports filed with the Postal Regulatory Commission (PRC) and made available to Congress and stakeholders. We will continue to give extensive information to Congress through the Annual Report, the Comprehensive Statement on Postal Operations, the Annual Network Update to Congress, oversight hearings, and responses to numerous questions submitted in connection with oversight hearings. We also file with the PRC our Annual Compliance Report, which provides detailed information about most aspects of our

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business. Whenever we plan an operational change that would cause a nationwide or substantially nationwide change in service, we provide extensive information in order to secure an advisory opinion from the PRC. In addition, the GAO and the Postal Service Office of Inspector General (OIG) routinely audit numerous aspects of the Postal Service's business and provide their findings to Congress.

Key Strategies and Options

In addition to the matters for Congressional consideration discussed above, the GAO report contains "key strategies and options" in three categories for addressing the Postal Service's situation: (1) reducing compensation and benefits costs; (2) reducing other operations and network costs and improving efficiency, and (3) generating revenues through product and pricing flexibility. Each of these strategies and options is also contained in the Postal Service plan.

Category 1: *Reducing compensation and benefits costs*

We agree with the GAO that we must reduce employee-related costs and increase workforce and work rule flexibility. We note that significant portions of these costs are imposed by statute; namely, the requirements for employee participation in the CSRS or FERS pension plans and retiree health benefits.

Because wages and benefits comprise 80 percent of Postal Service costs, viability is inextricably tied to the level of benefits provided. We must have more control over total compensation. Congressional action should be taken to permit the Postal Service to bargain with postal unions over pension and retiree health programs eligibility and costs, and to reduce pension and retiree health obligations in connection with new employees.

Category 2: *Reducing other operations and network costs and improving efficiency*

We agree that reducing operations and network costs is necessary, and are working hard to accomplish that. While more facilities need to be closed, over the past ten years, the Postal Service has made remarkable reductions in operations and network costs.

Because wages and benefits are such a large proportion of the Postal Service's costs, we have focused first on reducing work hours and personnel as the most important factors in improving the efficiency of our network. Between 2000 and 2010, the Postal Service reduced complement in plant operations by 98,000 employees: from 228,000 in 2000 to 130,000 in 2010.

We concur with the GAO that individual facility decisions are best made in the context of an integrated approach that optimizes the entire mail processing network. To achieve the efficiencies and benefits of a comprehensive network approach driven by good operational and economic intentions, the Postal Service needs the freedom to make independent operational decisions regarding the activities for which it is responsible, with fewer political roadblocks. As the GAO's report notes, the Postal Service faces formidable resistance to facility closures and consolidations. Work we are doing with the OIG to enhance the process for identifying Area Mail Processing consolidation opportunities takes into consideration service standards, customer concerns, and the local business environment and should help reduce such resistance.

Category 3: *Generating revenues through product and pricing flexibility*

We agree that Congress should consider allowing the Postal Service to broaden product and service offerings, consistent with our mission, as a means of financing universal service and continuing to be responsive to the changing needs of our customers. Revenue from additional products and services would help finance universal service and help avoid the need for appropriations.

In addition to the flexibility to pursue new avenues of revenue generation, we need to modernize the regulatory structure for developing new products and services. A modern structure would allow the speed and flexibility required in today's marketplace. The Postal Accountability and Enhancement Act of 2006 (PAEA) expanded both the scope and degree of oversight imposed on the Postal Service in ways that have proven to be inconsistent with the principle that we operate like a business. For example, all pricing decisions, even on the smallest customer contracts, require the PRC to conduct a before-the-fact review (i.e., before pricing decisions can be implemented). This is not how the marketplace operates and not the way our customers interact with our competitors. A regulatory structure could be designed to allow for an after-the-fact review of pricing and product decisions while still maintaining adequate transparency, customer input, and accountability.

The report also asks whether the Postal Service should be required to sustain loss-making products, or be allowed to pierce the price cap to ensure that such products cover their attributable costs. We believe that all postal customers should not have to bear the losses caused by certain products that do not cover their costs. If Congress wishes to continue preferential pricing for some loss-making classes of products, taxpayers—not ratepayers—should subsidize them. In our plan, we recommend a price cap on market dominant products as a whole rather than by class so that we can price in response to market demand. This approach would also allow us to better adapt prices to the costs of specific products.

Other Issues Raised in the Report

In discussing the Postal Service's role, the GAO report identifies as an issue whether postal services are inherently governmental functions, and whether the Postal Service should be the only entity responsible for universal postal service. The report implies that multiple private sector providers already deliver mail, citing as an example "contractors who provide long-distance mail transportation and deliver mail to households located along sparsely populated highway routes." The Postal Service is the only entity with an obligation to deliver universal service. We do use contractors to perform services for the network, such as transportation and contract delivery. But the Postal Service controls the network and oversees all work performed within it.

Late in its report, the GAO raises the issue of reducing or eliminating the Postal Service's monopoly, and notes that some foreign posts have taken that step. In nearly all such instances, governments have provided their posts with subsidies to cover the universal service obligation, and expanded the posts' abilities to generate additional revenue from new lines of business. In some instances, posts were already earning substantial revenue from their longstanding participation in nonpostal businesses. Today, some earn more from nonpostal than postal sources.

The concept of opening up the Postal Service's business to private sector companies and contractors is often discussed. If given the opportunity to participate in the delivery of mail, private sector companies would avoid hard-to-reach or unprofitable delivery areas. This would increase the cost to the Postal Service of providing universal service because we would lose the revenue from the profitable delivery areas attractive to private sector enterprises, but continue to bear the expense of maintaining a universal network. Other countries where private competitors have taken on delivery services have protected their posts by requiring the competitors to provide or help fund universal service. So far, there is no country in the world where a new player is successfully providing universal service.

The report's discussion of the role of the Postal Service also asks whether it should continue to fulfill all of its current functions, or whether some functions could be discharged by other agencies. One of the functions mentioned is the enforcement of mail fraud and other statutes, which for over two centuries has been fulfilled by the Postal Inspection Service. Annual surveys have found the Postal Service to be the most trusted federal agency, and we believe one of the reasons is the existence of the Postal Inspection Service. Transferring the Inspection Service or

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its duties to another agency would diminish that trust and adversely impact our brand and our revenues.

The contents of the GAO's report support many of the actions outlined by the Postal Service's plan. We agree, as the GAO said when adding the Postal Service to the high-risk list last year, that "Action is needed in multiple areas, including possible action and support by Congress; no single change will be sufficient to address USPS' challenges." The plan we outlined on March 2 is consistent with the GAO's call last year to "develop and implement a broad restructuring plan" that would include key milestones and time frames for actions, address key issues, and identify what steps Congress and other stakeholders may need to take.

Again, I appreciate the professional approach and the time the GAO has put into this report in the interest of identifying for Congress strategies to help ensure the Postal Service's financial viability. The Postal Service welcomes further discussion with you and your staff about any of these comments.

Sincerely,

John E. Potter

John E. Potter

Appendix III: GAO Contact and Staff Acknowledgments

GAO Contact

Phillip Herr, (202) 512-2834 or herrp@gao.gov

Staff Acknowledgments

In addition to the individual named above, Shirley Abel, Amy Abramowitz, Teresa Anderson, Joseph Applebaum, Gerald Barnes, Joshua Bartzen, William Dougherty, Patrick Dudley, Brandon Haller, Carol Henn, Paul Hobart, Kenneth John, Anar Ladhani, Hannah Laufe, Scott McNulty, Daniel Paepke, Susan Ragland, Amy Rosewarne, Travis Thomson, Jack Wang, and Crystal Wesco made key contributions to this report.

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