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U.S. POSTAL SERVICE

Actions Needed to Stave off Financial Insolvency

Statement of Phillip Herr, Director
Physical Infrastructure Issues

U.S. Government Accountability Office

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U.S. POSTAL SERVICE

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GAO
Accountability * Integrity * Reliability

Highlights

Highlights of GAO-11-926T, a testimony before the Committee on Homeland Security and Governmental Affairs, U.S. Senate.

Why GAO Did This Study

By the end of this fiscal year—in less than one month—the U.S. Postal Service (USPS) projects that it will incur a $9 billion loss; reach its $15 billion borrowing limit; not make its $5.5 billion retiree health benefits payment; and thus, become insolvent. USPS recently summarized this situation as the equivalent of facing Chapter 11 bankruptcy. In August 2011, USPS outlined new proposals to address the crisis. USPS seeks legislation to remove itself from the federal health benefit program and sponsor its own program; change pension benefits for new employees; and eliminate the layoff provisions it negotiated with its unions in collective bargaining to accelerate its delivery, processing, and retail network and workforce downsizing. Other USPS proposals, such as moving to 5-day delivery, and pending legislation include additional options for consideration.

This statement discusses (1) updated information on USPS's financial crisis and (2) GAO's review and analysis of proposals to address this crisis, including USPS's new proposals, and options in current legislation. The testimony is based primarily on GAO's review of pending legislation, past and ongoing work related to postal issues, as well as USPS's recent financial results and GAO's discussions with senior postal officials regarding USPS's recent proposals. GAO has reported that action by Congress and USPS is urgently needed to restore USPS's financial viability. GAO provided a draft statement to USPS for comments and did not receive any suggested changes.

View GAO-11-926T. For more information, contact Phillip Herr at (202) 512-2834 or herrp@gao.gov.

What GAO Found

USPS has experienced a cumulative net loss of nearly $20 billion over the last 5 fiscal years, including an $8.5 billion loss in 2010, and a net loss of $5.7 billion in the first 9 months of fiscal year 2011. USPS does not now have—nor does it expect to have—sufficient revenue to cover its costs without legislative changes. To conserve cash, USPS discontinued making its employer's contribution for the defined-benefit portion of the Federal Employees Retirement System (FERS) in June 2011, which it estimated would reduce its costs by about $800 million this fiscal year. USPS has said that mail volume decline has outpaced even its most pessimistic forecasts. USPS urgently needs to restructure its networks and workforce as its financial condition and outlook have reached a crisis level.

A variety of proposals have been made to address USPS's financial crisis. These proposals affect USPS cost savings, postal rates, customer convenience, pension benefits for new employees, employee health benefits, collective bargaining agreements, and delivery and retail services. GAO has identified key issues needing consideration in determining the merits of these proposals. Examples of specific proposals and key considerations include:

- USPS proposal to sponsor its own health benefit plan: USPS expects to save costs by increasing employee contribution rates, fully utilizing Medicare benefits, and administering its plan more efficiently than OPM. However, it is not clear whether USPS can achieve planned cost savings and what the implications are for the federal budget, as USPS has requested about $42 billion in retiree health benefit assets be transferred from Treasury to a USPS Fund.
- USPS proposal to seek reimbursement of its $6.9 billion FERS surplus: Reimbursing the entire surplus all at once is a risk as the current FERS surplus is an estimate that could change as economic or demographic assumptions change. The President's Fiscal Year 2012 Budget Request proposed amortizing the reimbursement over 30 years, which would be consistent with the approach taken for any deficits.
- USPS proposal on workforce optimization: USPS expects to reduce costs by closing about 300 mail processing plants and 12,000 retail facilities; reducing service; and eliminating layoff protections in collective bargaining agreements so that it can reduce its total workforce by about 125,000 career employees by 2015. This proposal accelerates the pace of USPS actions in this area, but it is not clear how USPS will address public resistance to facility closures that could lengthen the timeframes for implementation; employee resistance to making legislative changes to layoff protections; and potential loss of customers if service declines or costs increase.

Little time remains to prevent USPS—the largest federal civilian employer—from insolvency. The stark reality is that USPS's business model is broken. The decline in mail volumes is continuing. The gap between revenues and expenses is growing. USPS cannot continue providing services at current levels without dramatic changes in its cost structure. Difficult choices must be made. Now is the time to decide USPS's future.

Chairman Lieberman, Senator Collins, and Members of the Committee:

I am pleased to be here today to participate in this hearing focused on the challenges facing the U.S. Postal Service (USPS). USPS is in a serious financial crisis, and as mail volume continues to decline, it has not generated sufficient revenue to cover its expenses and financial obligations. In less than a month, USPS officials project that it will be insolvent and default on its statutorily-mandated retiree health payment. USPS has concluded that extraordinary steps must now be taken to restore it to sound financial footing. Critical decisions by Congress and USPS are needed to both avoid this projected default of the largest federal civilian employer and address USPS's financial and operational challenges.

This testimony discusses (1) updated information on USPS's financial crisis and (2) our review and analysis of proposals to address this crisis that include pending congressional legislation and recent USPS proposals that would allow it to withdraw from the federal health benefit program and sponsor its own program, change the pension program for new hires, and accelerate its network and workforce optimization efforts. The testimony is based primarily on our review of pending legislation, GAO's past and ongoing[1] work, as well as GAO's review of USPS's recent financial results and our discussions with senior postal officials regarding USPS's recent proposals.

We performed this work from August 2011 to September 2011 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.

[1]We have several ongoing reviews that are assessing USPS's plans and actions to (1) close retail facilities; (2) expand access to retail alternatives operated by private contractors; (3) reduce mail processing excess capacity and close unneeded facilities; and (4) consolidate area and district administrative offices.

USPS's Financial Crisis Has Worsened, and USPS Is Likely to Face Insolvency

As we have noted previously, USPS urgently needs to restructure its networks and operations as its financial condition and outlook have reached a crisis level. USPS has experienced a cumulative net loss of nearly $20 billion over the last 5 fiscal years, including an $8.5 billion loss in 2010; and a reported net loss of $5.7 billion in the first 9 months of fiscal year 2011. By the end of this fiscal year, USPS projects that it will incur a $9 billion loss, experience a substantial cash shortfall, reach its $15 billion borrowing limit, and not make its statutorily mandated $5.5 billion retiree health benefits payment to the federal government. USPS summarized its situation as the equivalent of facing Chapter 11 bankruptcy.

USPS's financial problems are related to customers' changed mail use—that is, mail volume is declining as people shift to electronic communications and payment alternatives rather than using USPS. Total mail volume peaked in fiscal year 2006 at 213 billion pieces and declined by almost 20 percent to about 170 billion pieces by the end of fiscal year 2010. In the first 3 quarters of this fiscal year, the volume for First-Class Mail—USPS's most profitable product that accounted for 49 percent of USPS operating revenue—has declined by 6.5 percent compared to the same period last year. USPS has said that mail volume declines and changes in the mail mix have outpaced even its most pessimistic forecasts. USPS has projected a further drop in total mail volume to about 133 billion pieces by 2020.

USPS does not now have—nor expects in the future to have—sufficient revenue to cover its costs without legislative changes. These costs include compensation and benefits for a workforce of about 653,000 total employees, a network of about 33,000 USPS-operated retail[2] and processing facilities, and 6-day delivery services to about 150 million locations, which expands by roughly 1 million new residences and businesses each year. USPS had $67 billion in revenue in fiscal year 2010 and $75.5 billion in expenses, resulting in a loss of $8.5 billion, which it expects to grow to a $20 billion loss by 2015. USPS also faces a variety of challenges, including difficulties reducing costly excess capacity in its networks; closing facilities due to stakeholder resistance or statutory

[2]USPS-operated retail facilities include (1) main post offices, where local postmasters oversee retail operations in the geographic area; (2) postal stations located within a municipality's corporate limits; and (3) postal branches located outside a municipality's corporate limits.

and regulatory requirements that restrict closings; and making the annual prefunding retiree health benefit payments of about $5.5 billion required since 2006.[3] For these reasons, we placed USPS's financial condition and outlook on our list of high-risk programs and agencies in 2009, and it remains on our updated list in 2011.[4]

Proposals to Address USPS's Financial Crisis

We have reviewed a variety of proposals to address USPS's ongoing financial difficulties by reducing costs and improving operational efficiency, but the overall effects of these proposals are uncertain because many questions remain. In August 2011, USPS released two discussion drafts that outline major proposals to (1) seek legislative authority to withdraw USPS from the Federal Employee Health Benefit (FEHB) program and sponsor its own program and change pension benefits for new employees, and (2) seek legislative authority to eliminate the layoff protections it negotiated with its unions in collective bargaining to accelerate network and workforce downsizing.[5] USPS has not fully developed these proposals, so answers are not available to many of the questions that have been raised. We also reviewed other proposals including

- USPS proposals to seek reimbursement of the surplus in its Federal Employees Retirement System (FERS) account and reduce costs by moving to 5-day delivery, restructuring its retail network, and reducing excess capacity in its mail processing network;

[3]In 2006, Congress established a 10-year schedule of USPS payments into a fund (the Postal Service Retiree Health Benefits Fund) that average $5.6 billion per year through fiscal year 2016. Starting in fiscal year 2017, USPS's share of the health benefit premiums for current and future retirees will be paid from this fund and USPS will also fund the actuarially determined normal cost plus an amortization of any unfunded liability. Pub. L. No. 109-435, § 803(a).

[4]GAO, *High-Risk Series: Restructuring the U.S. Postal Service to Achieve Sustainable Financial Viability*, GAO-09-937SP (Washington, D.C.: July 28, 2009). *High-Risk Series: An Update*, GAO-11-278 (Washington, D.C.: February 2011).

[5]See *http://about.usps.com/news/national-releases/2011/pr11_wp_hbretirees_0812.pdf* and *http://about.usps.com/news/national-releases/2011/pr11_wp_workforce_0812.pdf*.

- pending legislation, including bills introduced in the Senate by Senators Carper and Collins and in the House of Representatives by Representatives Issa and Lynch;[6]
- the President's Fiscal Year 2012 Budget Request;
- our recent work, including our April 2010 report on USPS's business model which (1) concluded that this model is broken and that USPS needs to take more aggressive action to better align costs with revenues[7] and (2) discussed a series of options that included restructuring USPS's retiree health prefunding payments, adjusting its workforce mix to more part-time staff, closing unneeded retail and mail processing facilities, and moving to 5-day delivery; and,
- reports by the U.S. Postal Service Office of Inspector General (USPS OIG) and the U.S. Office of Personnel Management Office of Inspector General (OPM OIG) related to changing the funding of USPS's pension and retiree benefits.[8]

Proposals Related to Reducing Benefit Costs

The key considerations of the USPS benefit-related proposals include the financial impact on USPS, its employees, future hires, retirees, the federal budget, and benefit programs and USPS's ability to administer its own program. USPS costs for participating in the federal government-sponsored pension, health benefit, and workers' compensation programs totaled about $22 billion in fiscal year 2010, almost 30 percent of its total expenses. This total included $5.8 billion for retirement benefits (FERS, Social Security, and the Thrift Savings Plan), $12.8 billion for health benefits, and $3.6 billion for workers' compensation expenses. USPS was

[6] On May 17, 2011, Senator Carper introduced the Postal Operations Sustainment and Transformation Act of 2011. S. 1010, 112th Cong. (2011). On February 15, 2011, Senator Collins introduced the U.S. Postal Service Improvements Act of 2011. S. 353, 112th Cong. (2011). On June 23, 2011, Representative Issa introduced the Postal Reform Act of 2011. H.R. 2309, 112th Cong. (2011). On April 4, 2011, Representative Lynch introduced the United States Postal Service Pension Obligation Recalculation and Restoration Act of 2011. H.R. 1351, 112th Cong. (2011).

[7] GAO, *U.S. Postal Service: Strategies and Options to Facilitate Progress toward Financial Viability,* GAO-10-455 (Washington, D.C.: Apr. 12, 2010).

[8] U.S. Postal Service Office of Inspector General, *"Management Advisory – Substantial Savings Available by Prefunding Pensions and Retirees' Health Care at Benchmarked Levels,"* Report Number FT-MA-11-001 (Arlington, VA: November 23, 2010) and U.S. Office of Personnel Management Office of the Inspector General, "*A Study of the Risks and Consequences of the USPS OIG's Proposals to Change USPS's Funding of Retiree Benefits*" (Washington, D.C.: Feb. 28, 2011).

not required to make any payments for Civil Service Retirement System (CSRS) pensions in fiscal year 2010.[9]

Employee Health Benefits

USPS currently has approximately 600,000 active employees and 480,000 annuitants participating in the FEHB program. In fiscal year 2010, USPS recorded over $12.8 billion in health care costs: $5.1 billion in costs for current employees, $2.2 billion in premium costs for current retirees, and $5.5 billion for prefunding premium costs. USPS employees paid about 20 percent of their premium costs in fiscal year 2010 as compared to about 28 percent paid by other federal employees. USPS reported in its fiscal year 2010 annual report that its Retiree Health Benefits Fund had assets of $42.5 billion. USPS's proposal stated that these assets would cover 47 percent of all future liabilities for current and future retirees. Going forward, USPS's health-related benefit costs will continue to face pressure from rising health care premiums, continued prefunding requirements, and increasing number of retirees (USPS estimates that about 300,000 employees will be eligible to retire over the next decade).

USPS has proposed establishing and managing its own health benefits program. Its proposal briefly discusses USPS's rationale, how it would go about creating such a program, the governance and oversight structure, and it views of the unions' role under the proposed process. While the Postal Service believes it currently has authority to withdraw from the FEHB program pursuant to section 1005(f) of title 39 of the United States Code, it has stated that it will seek specific statutory authority to do so. USPS is authorized to vary, modify, or add to certain fringe benefits, but is prohibited from making any changes to fringe benefits that on the whole are less favorable than the fringe benefits in effect when the Postal

[9] 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. Congress responded by enacting the Postal Civil Service Retirement System Funding Reform Act of 2003, which changed the prior method of estimating and funding the USPS CSRS pension obligations. Pursuant to the Postal Accountability and Enhancement Act, USPS is not required to make contributions for CSRS employees' retirement through fiscal year 2017 when the Office of Personnel Management (OPM) is required to perform an actuarial valuation to determine whether USPS has a pension surplus or liability. If USPS has a pension liability, OPM must establish an amortization schedule by 2017 for additional payments. Pub. L. No. 109-435, § 802(a) (Dec. 20, 2006).

Reorganization Act of 1970 was enacted.[10] The Postmaster General has stated, however, that USPS may alter benefits for certain categories of employees under any health benefits program it would administer.

Our April 2010 report on USPS's business model discussed several options and related issues pertaining to assigning financial responsibility for benefits to USPS, its employees, and current and future ratepayers. Key considerations include improving USPS's poor financial condition while keeping rates affordable, ensuring adequate funding to fulfill its financial obligations pertaining to employee benefits, and minimizing risk to the taxpayer if USPS would be unable to meet its responsibilities. USPS has said it cannot afford its required prefunding payments to the Retiree Health Benefits Fund on the basis of its significant mail volume and revenue declines, large financial losses, and difficulties in reducing costs. We have reported that Congress should consider a package of actions, which could include providing financial relief to USPS by modifying its retiree health benefit cost structure in a fiscally responsible manner.

Several legislative proposals have been made to defer costs by revising statutory requirements, including extending and revising prefunding payments to the Retiree Health Benefits Fund, with smaller payment amounts in the short term followed by larger amounts later. Deferring some prefunding of these benefits would serve as short-term fiscal relief. However, deferrals also increase the risk that USPS will not be able to make future payments as its core business declines. Therefore, it is important that USPS continue to fund its retiree health benefit obligations—including prefunding these obligations—to the maximum extent that its finances permit. At this point, however, USPS will be challenged to make these payments and says it will not be able to this year.

[10]This provision authorizes USPS to vary, modify, or add to certain components of federal unemployment compensation, life insurance, and certain components of health insurance, subject to provisions in title 39. The provision, however, states that "[n]o variation, addition, or substitution with respect to fringe benefits shall result in a program of fringe benefits which on the whole is less favorable to officers and employees than fringe benefits" in effect upon enactment of the Postal Reorganization Act of 1970. In addition, for employees covered by a collective bargaining agreement, variations, additions, or substitutions may only be made by agreement between the collective bargaining representative and the Postal Service. 39 U.S.C. § 1005(f).

Table 1 describes health benefit-related proposals from USPS, pending legislation (bills introduced in 2011 by Senators Carper and Collins and Representatives Issa and Lynch), the President's Fiscal Year 2012 Budget Request, GAO's report on USPS's business model (GAO-10-455), and a report by the USPS OIG,[11] along with key issues that we have identified.

Table 1: Proposals to Modify USPS's Health Benefit Structure and Key Issues to Consider

Proposals	Key Issues to Consider
Allow USPS to sponsor its own health benefit program: • USPS has proposed establishing its own health benefit program (thus removing it from the federal program administered by the Office of Personnel Management), which would differentiate benefits based on category of participant. • To implement this proposal, USPS said that it would have to receive the $42.5 billion in assets currently in the Postal Service Retiree Health Benefits Fund.	• USPS did not provide an estimate of the financial benefits related to its proposal. • USPS believes it could achieve higher returns on invested assets and lower costs from simplifying the plan structure, achieving discounts on drug purchases, requiring eligible retirees to fully utilize Medicare benefits, and reducing retiree health benefits for employees after 2013.
Transfer surplus CSRS funds to USPS Retiree Health Benefits Fund: • Pending legislation would transfer any surplus CSRS funds (if Congress transfers responsibility for the effect of post-1971 salary increases on pre-1971 pension service) to USPS's Retiree Health Benefits Fund, and if it is fully funded, USPS could use the surplus to make its workers' compensation payments or reduce its debt.	• There are two variations on this proposal, involving technical details of the CSRS benefit formula, with estimated impacts ranging from $50 billion to $75 billion.
Use a "pay-as-you-go" approach to revise retiree health benefit payments: • In March 2010, USPS proposed shifting to a pay-as-you-go system (for its retiree health benefits), and paying premiums as they are billed for current retirees. • GAO discussed different variations on a pay-as-you-go approach in its April 2010 report (GAO-10-455), such as using the Retiree Health Benefits Fund to pay USPS's share of retiree health premiums for current retirees until the Fund is exhausted and then reverting to USPS funding future premiums from its operations by paying the FEHB Fund directly.	• GAO estimated that one pay-as-you-go approach would reduce USPS's total payments by over $44 billion dollars through fiscal year 2020, but would also result in a $66 billion increase in USPS's unfunded obligation in fiscal year 2020. • Any deferral of the currently required prefunding payments could impact the federal budget.

[11] USPS OIG, FT-MA-11-001.

Proposals	Key Issues to Consider
Use an actuarial approach to revise retiree health benefit payments: • The President's Fiscal Year 2012 Budget Request proposed restructuring the mandated prefunding payments to an accrual cost basis, which would save USPS $4 billion in 2011. • GAO's 2010 report discussed this option, whereby payments include 1) amounts for "normal costs," that is, the costs to finance the future retiree health benefits attributed to the service of current employees and 2) amortization amounts to liquidate unfunded obligations over a 40-year period.	• The President's Budget Request estimated the deficit effect of this proposal would be $5 billion over the fiscal year 2011 to 2021 budget period. • GAO estimated this actuarial approach would reduce USPS's total payments compared to current law by nearly $10 billion dollars through fiscal year 2020, but would also increase USPS's unfunded obligation by $15 billion in fiscal year 2020.
Increase employees share of health benefit premiums: • Pending legislation would require USPS employees to pay the same health insurance premium percentage as other federal workers. • GAO's 2010 report discussed an option that would more closely align USPS's share of the health insurance premium payments with that paid by most federal agencies. Collective bargaining agreements require USPS to pay a more generous share of employees' health insurance premiums than most other federal agencies (USPS paid, on average, 80 percent of health benefit premiums in fiscal year 2010 compared with 72 percent by other federal agencies).	• USPS estimated that decreasing its share of health benefit premium payments from 80 percent to 72 percent would have saved USPS about $560 million in fiscal year 2010.
Change prefunding required for retiree health benefits: • In a November 2010 report, the USPS OIG recommended that USPS prefund its retiree health benefits at 30 percent of its liability.	• Using a funding target of less than 100 percent can have the effect of passing along costs of current services to future ratepayers. • Reducing the level of prefunding could increase the risk that taxpayers may have to fund this liability if USPS defaults.

Source: GAO analysis.

Note: The proposals reviewed for this table include USPS August 2011 discussion paper regarding Health Benefits and Retirement Programs; legislative proposals from the Postal Operations Sustainment and Transformation Act of 2011, S. 1010; the U.S. Postal Service Improvements Act of 2011, S. 353; the United States Postal Service Pension Obligation Recalculation and Restoration Act of 2011, H.R. 1351; the U.S. Postal Service Improvements Act of 2011, S. 353; the Postal Reform Act of 2011, H.R. 2309; the President's Fiscal Year 2012 Budget Request; GAO report (GAO-10-455); and USPS OIG report (FT-MA-11-001).

Some of the key questions that should be considered by Congress, USPS, and other stakeholders regarding USPS's recent proposal to create its own health benefit program include:

- Legal authority – While USPS has stated that it will request legislative authority to withdraw from FEHB and start its own health benefit program, what other legal and regulatory provisions (e.g., its retiree health prefunding requirements[12]) may be affected by such a withdrawal?

[12] Pub. L. No. 109-435, § 803.

- Budgetary – What impact would such a move have on the federal budget, particularly transferring $42 billion in assets from the current Treasury-held Fund to the proposed Postal Service-administered health benefits program?

- Financial impact to USPS – What savings would USPS expect from such a shift, both in the short-term and in the longer-term? How would such a change impact USPS health benefit contribution rates and costs? How would the current costs paid by USPS to OPM to administer the program compare to those USPS expects to incur by administering the program itself?

- Employee impacts – What would be the expected impact on employees' contribution rates, costs, and benefits? What would be the impact of this proposal on collective bargaining?

- Impact on other federal employees – How would the benefits, contribution rates, and costs of other federal employees enrolled in FEHB be impacted by this proposal? Also, how would non-USPS federal employees[13] who are currently enrolled in postal union sponsored FEHB plans be impacted?

- Fiduciary responsibility – How does USPS plan to acquire the experience needed to sponsor health benefit programs for over 1 million participants? Who would decide what the required funding level and investment strategy should be? Also, if USPS defaults on benefit payments, what would be the federal government's obligation?

- Oversight – How would disagreements between the proposed Plan Management body and USPS and/or employees be resolved, e.g. scope of coverage, procedures, etc.?

USPS Pension Benefits

Approximately 84 percent of eligible USPS employees are enrolled in FERS, and about 16 percent are enrolled in CSRS or the Dual CSRS/Social Security program; these programs are administered by the Office of Personnel Management (OPM). At the end of fiscal year 2009, OPM estimated that USPS had an unfunded CSRS liability of $7.3 billion

[13]Three of the four major postal-union sponsored FEHB plans are open to all federal employees.

and a FERS surplus of $6.9 billion.[14] USPS has asked Congress to enact legislation that would allow it to access the FERS surplus. To conserve cash immediately, however, in June 2011, USPS discontinued making its employer contribution payments for the defined benefit portion of FERS.[15] The current $6.9 billion FERS surplus is approximately equal to 2 years of USPS's FERS contributions that it has stopped making. Thus, if USPS continues not to make its FERS payments, its FERS surplus will be reduced by a commensurate amount. USPS estimated this would reduce its costs by about $800 million in the current fiscal year but would not impact current or future postal retirees.[16] Both USPS and the OPM agreed to seek a resolution of the legal issues surrounding USPS's decision to discontinue its FERS payments by requesting a legal opinion from the Office of Legal Counsel at the Department of Justice.

USPS has proposed legislation that would make new employees eligible only for the Thrift Savings Plan (possibly modified) and Social Security. New employees would not be eligible for the FERS defined benefit annuity or CSRS. USPS's proposal included a brief description of why USPS is requesting this change as well as what postal officials perceived as inconsistencies between the current pension system and the "pay comparability"[17] factor and what they have characterized as "over-payment" concerns. There is disagreement regarding whether USPS has "overpaid" CSRS between $50 billion and $75 billion. The USPS OIG and Postal Regulatory Commission have asserted that the current method of allocating pension costs for pay increases after 1971[18] results in the

[14]These annual OPM estimates for the CSRS liability and FERS surplus are subject to change based on experience and future estimates of various economic and demographic factors, such as interest rates, inflations rates and cost-of-living adjustments, longevity, and retirement behavior. The current CSRS liability makes it more likely than not that additional CSRS payments would become necessary beginning in 2017 (see footnote 9).

[15]FERS is a three-tiered retirement plan consisting of a defined benefit annuity, the Thrift Savings Plan, and Social Security.

[16]However, the deferral of these payments increases the risk to either plan participants or to Treasury, should the USPS portion of FERS go into deficit (because of either adverse experience or as additional benefits accrue) and USPS is unable to make up the value of these missed payments in the future.

[17]USPS is required by law to maintain compensation and benefits for its officers and employees comparable to the private sector. 39 U.S.C. § 101(c).

[18]Responsibility for paying for the increase in retirement benefits for pre-1971 service of postal employees due to increases in postal salaries since July 1, 1971 was transferred from the U.S. Treasury to USPS by statute in 1974. Pub. L. No. 93-349 (July 12, 1974).

inequitable allocation of pension obligations to USPS, and the USPS OIG proposed an alternative allocation methodology. In response, the OPM OIG has asserted that OPM does not have the authority to adopt this proposal without further legislation, that a change in the allocation methodology would shift substantial pension funding costs from USPS to the U.S. Treasury, and that using the federal retirement program as a vehicle through which to implement other policy objectives would be unwise, inefficient, and harmful to the program itself.[19]

Table 2 describes key provisions from USPS's retirement-related proposals, pending legislation (bills introduced in 2011 by Senators Carper and Collins, and Representatives Issa and Lynch), the President's Fiscal Year 2012 Budget Request, GAO's report on USPS's business model (GAO-10-455), and a report by the USPS OIG,[20] along with key issues that we have identified.

Table 2: Proposals to Modify USPS's Pension Plan and Key Issues to Consider

Proposals	Key Issues to Consider
Revise pension plan for new hires: • In August 2011, USPS proposed legislation to change the pension plan for new hires from a defined benefit plan to a defined contribution plan, which would eliminate the FERS annuity, and give USPS more flexibility to determine contributions to the Thrift Savings Plan. The retirement plan for USPS's existing CSRS and FERS employees would stay the same.	• USPS did not provide an estimate of the financial benefits related to its proposal. • USPS's savings would come from eliminating the FERS annuity for new hires and possibly modifying participation in the Thrift Savings Plan
Revise USPS's CSRS liability and transfer any surplus to Retiree Health Benefits Fund: Several pending bills would • adjust the methodology OPM uses to reflect a shift in responsibility for these benefits from USPS to the federal government. (USPS has disputed who is responsible for the impact of post-1971 salary increases on pension benefits tied to pre-1971 service.) • allow any resulting CSRS surplus to be transferred to USPS's Retiree Health Benefits Fund.	• This proposal is expected to make the federal government responsible for a greater share of USPS's CSRS pension obligation, with cost estimates ranging from \$50 billion to \$75 billion. • Any authorized transfer of CSRS funds to USPS would have an impact on the federal budget.

[19]OPM OIG, *A Study of the Risks and Consequences of the USPS OIG's Proposals to Change USPS's Funding of Retiree Benefits*.

[20]USPS OIG, FT-MA-11-001.

Proposals	Key Issues to Consider
Reimburse USPS for the current surplus in OPM's FERS Fund – estimated $6.9 billion: • USPS proposed giving it immediate access to the FERS surplus. • The President's Fiscal Year 2012 Budget Request proposed an annual appropriation (an estimated $550 million in 2011) amortized over 30 years to reimburse USPS for its current FERS surplus.	• The FERS surplus is an estimate that could change as economic or demographic assumptions change. Amortizing any reimbursement over a longer time period would be consistent with the actuarial approach taken for any deficits. • USPS's proposal does not specify how surplus funds would be used.
Allow USPS to prefund the CSRS and FERS pension programs at 80 percent of their liability: • The USPS OIG proposed reducing the prefunding target for CSRS and FERS from 100 percent to 80 percent so that USPS could meet its obligation while conserving cash and improving its financial condition. According to the USPS OIG, if USPS implemented this change in prefunding, it would save $51.4 billion.	• Reducing prefunding amounts would provide USPS with short-term financial relief but would increase the long-term risk of funding these payments. • Any changes to the required prefunding levels could affect the federal budget. • Requiring USPS to fully prefund its retiree liabilities provides important protection for taxpayers by guaranteeing that USPS will continue to pay its own expenses. • Using a funding target of less than 100 percent can have the effect of passing along costs of current services to future ratepayers.

Source: GAO analysis.

Note: The proposals reviewed for this table include USPS August 2011 discussion paper regarding Health Benefits and Retirement Programs; legislative proposals from the Postal Operations Sustainment and Transformation Act of 2011, S. 1010; the United States Postal Service Pension Obligation Recalculation and Restoration Act of 2011, H.R. 1351; the President's Fiscal Year 2012 Budget Request; GAO report (GAO-10-455); and USPS OIG report (FT-MA-11-001).

The following questions provide a starting point to consider USPS's proposal to withdraw from the federal pension programs:

- USPS legal authority – USPS would require new statutory authority to withdraw future employees from the federal pension annuity.[21] USPS proposes to eliminate the FERS annuity for new employees so that their benefits are comparable to the private sector. Is additional clarification needed to determine whether USPS's pension proposal for new employees is comparable to the private sector?
- Budgetary – What would be the impact on the federal budget of transferring the $6.9 billion FERS surplus to USPS?

[21] 39 U.S.C. § 1005(d)(1).

- Financial impact to USPS – What savings would be expected from eliminating the FERS annuity for new hires?
- Employee impacts – How would such a change impact employees' and USPS's contribution rates to the Thrift Savings Plan for new hires?

Further analysis may also be needed of other options that could be considered to reassess USPS's current pension program. For example, flexibilities within FERS can accommodate different accrual rates for certain groups of employees (e.g., law enforcement officers and congressional employees). Thus, through legislation, FERS benefits for USPS employees could potentially be modified.

Other Employee Benefits

USPS also provides other benefits to employees, including workers' compensation and life insurance (which cost nearly $3.6 billion and $210 million respectively in fiscal year 2010). Although neither of these benefits is discussed in USPS's recent draft proposals, legislation[22] has been introduced that would convert employees on long-term workers' compensation to federal retirement programs when they reach retirement age. Furthermore, USPS offers employees life insurance coverage through the Federal Employees' Group Life Insurance (FEGLI) Program. USPS pays 100 percent of employee basic life insurance premiums, while other federal agencies pay about 33 percent. One option discussed in our April 2010 report would be for USPS to work with its unions in collective bargaining to increase employee premium payments for these benefits—and, in doing so, reduce USPS's share to levels paid by most federal agencies. USPS estimated that this would have saved about $130 million in fiscal year 2010.

Proposals to Reduce Costs through Network and Workforce Optimization

We have noted in a number of reports and testimonies that USPS needs to eliminate costly excess capacity in its networks due to declining mail volume, increased automation, and incentives that allow mailers to bypass USPS processing by entering 83 percent of Standard Mail, (primarily advertising) closer to its destination in return for a discount. Technological innovations such as advanced sorting machines can rapidly process and sequence mail, leaving less manual work for USPS employees. Moreover, although customer visits and retail revenue have

[22]The U.S. Postal Service Improvements Act of 2011, S. 353, 112th Cong. (2011).

declined, USPS has not made commensurate reductions in its retail facilities. USPS reports that about 35 percent of its retail sales are performed at sites other than a traditional post office, such as stamp purchases at grocery stores or on the Internet. Together, these and other developments have resulted in the need for a smaller postal operational network and workforce.

During the past 12 years, USPS reported that it reduced its workforce by 235,000 career employees, primarily through attrition. Currently, USPS has about 653,000 total employees, and has a goal of reducing that number to 425,000 by 2015. USPS plans to increase the ratio of non-career to career employees and expects attrition to eliminate about 100,000 employees. In order to meet its 2015 goal, USPS has asked for legislation to eliminate the layoff provisions it has negotiated with its unions in collective bargaining so that it can accelerate reducing its workforce by an additional 125,000 career positions. Currently, USPS's collective bargaining agreements with three of its major unions contain a provision stating that USPS bargaining unit employees, who were employed as of September 15, 1978, or, if hired after that date, have completed 6 years of continuous service, are protected against any involuntary layoff or force reduction. The collective bargaining agreement with its fourth major union states that that no bargaining unit employees employed in the career work force will be laid off on an involuntary basis during the period of the agreement.

USPS has proposed initiatives to remove more than $11 billion in costs from its networks and workforce. USPS plans to reduce the number of processing plants from over 500 to fewer than 200 and has proposed changing service standards to increase delivery time. USPS has announced plans to streamline its postal-operated retail facilities from 32,000 to fewer than 20,000 by 2015, and has already begun studying 3,700 retail facilities for possible closure. It also plans to continue increasing the number of locations where postal services are provided in privately owned businesses. We recently reported on similar retail restructuring efforts by some foreign posts and the lessons learned to facilitate the transitions, which took time to phase in and gain acceptance.[23] In addition to these network operations proposals, USPS is

[23]GAO, *U.S. Postal Service: Foreign Posts' Strategies Could Inform U.S. Postal Service's Efforts to Modernize*, GAO-11-282. (Washington, D.C.: Feb. 16, 2011).

also continuing to examine the locations of its area and district offices—where it has recent made progress by closing some of these offices.

USPS initiatives and legislative proposals outline significant changes in the retail, delivery, and processing network and workforce to achieve cost savings, including enhancing USPS's ability to close unneeded facilities and layoff employees. Coordination with customers will be important so that USPS efforts to reduce its costs will not result in significantly increasing costs or decreasing services to customers. Further, USPS has proposed increasing the efficiency of mail delivery by reducing delivery service from 6 to 5-days[24] and consolidating routes. Delivery remains the most costly activity for USPS and involves more than 310,000 carriers accounting for approximately 47 percent ($23 billion) of USPS's total salary and benefit expenses in fiscal year 2010. Key proposals and related issues are presented in Table 3.

Table 3: Key Network Optimization and Workforce Proposals

Proposals	Key Issues to Consider
Restructure retail network: • USPS recently announced an initiative to study 3,700 retail facilities for possible closure or conversion to contractor-operated postal units and reduce the total number of postal-operated retail facilities from 32,000 to fewer than 20,000 by 2015. • Several pending bills facilitate network-wide restructuring and require retail restructuring plans. One bill would set up a commission to recommend to Congress a list of retail facilities to be closed. This list would not be subject to the appeals process. If approved, USPS would be required to complete the closures within 2 years and achieve $1 billion in annual savings. • Pending legislation calls for expanding retail alternatives.	• USPS did not provide an estimate of the cost savings related to its retail closure initiative. • Revenue from customer visits to postal-operated facilities has declined as revenue from alternative retail locations has increased to about 35 percent of total revenue. • USPS plans to expand retail alternatives, which it estimated would save $1.5 billion annually and enhance service. • The closures under USPS's initiative would likely face public resistance and would be subject to the appeals process, which includes individual facility reviews, and may be time consuming.

[24]USPS annual appropriations have specified that "6-day delivery and rural delivery of mail shall continue at not less than the 1983 level." See e.g., Pub. L. No. 111-117, 123 Stat. 3200 (Dec. 16, 2009).

Proposals	Key Issues to Consider
Restructure processing network: • USPS proposed reducing the number of its processing plants from over 500 to below 200. • USPS has also proposed changing its service standards, such as extending the overnight delivery standard for First-Class Mail to 2 days, to reduce its processing network and transportation costs. • Pending legislation would establish an independent commission to recommend to Congress a list of processing plants for closure or consolidation. If approved by Congress, USPS would be required to complete these changes in 2 years and achieve $1 billion in annual savings.	• We have reported that USPS has a processing network that is too large to support current mail volumes. • USPS estimated that closing nearly 300 processing plants (and achieving related reductions in staff, equipment, and processing) would save $3 billion annually in costs. It is not clear how these changes would affect its customers' costs and service. • The timeframe proposed to achieve these savings could be ambitious given the planned reductions in workforce and potential public resistance to closures.
Adjust delivery frequency and other actions to increase delivery efficiency: • USPS proposed adjusting delivery frequency from 6 to 5 days a week. • USPS plans to eliminate 20,000 city delivery routes out of the current 142,000 city routes. • Other options discussed in GAO-10-455 include expanding the use of more cost-efficient modes of delivery, such as moving door deliveries to centralized deliveries.	• USPS estimated that it could reduce costs by more than $3 billion annually by moving to 5-day delivery and $2 billion annually from route adjustments. • Changing delivery frequency would require legislative and regulatory actions. • Past GAO work has noted that changing delivery frequency could reduce volume and revenue and negatively affect some customers, as well as reduce USPS's advantage over competitors that do not offer Saturday delivery.
Eliminate layoff protections and reduce workforce: • USPS seeks legislation to eliminate the layoff protections in collective bargaining agreements so its workforce could be reduced by more than 125,000 employees at an accelerated pace in conjunction with network reductions. • Pending legislation would establish a financial authority that could require renegotiation of existing collective bargaining agreements to achieve workforce flexibility and economic savings. Another provision would require an arbitration board, established to provide binding arbitration if the parties fail to reach agreement through collective bargaining, to consider USPS's current and long-term financial condition in its decision.	• Eliminating union layoff protections may have an impact on future negotiations with the postal unions. • GAO reported that Congress should consider revising the statutory framework for collective bargaining to ensure that binding arbitration takes USPS's financial condition into account.

Source: GAO analysis.

Note: The proposals reviewed for this table include a USPS August 2011 discussion paper titled, *Workforce Optimization*; legislative proposals from the Postal Operations Sustainment and Transformation Act of 2011, S. 1010 ; the U.S. Postal Service Improvements Act of 2011, S. 353; the Postal Reform Act of 2011, H.R. 2309; and GAO report (GAO-10-455).

These proposals require making trade-offs among USPS cost savings, customer convenience and costs, employee agreements, and expectations related to the level of services USPS can afford to provide. Some unresolved issues and questions to consider include:

- Universal service: What aspects of universal service, including 6-day delivery, are appropriate given the changed use of mail? What, if any, changes are needed to delivery standards to optimize USPS's processing network? Can USPS's proposed retail optimization improve customers' access to postal products and services through alternatives while also maximizing costs savings?

- Statutory and regulatory changes: What statutory or regulatory changes are needed to give USPS the flexibility it needs to restructure its operations, networks, and workforce, while also assuring appropriate oversight? Are changes needed to facilitate more timely review of appeals of retail facility closures and consolidations?

- Stakeholder involvement: What role, if any, should Congress, the Board of Governors, and the Postal Regulatory Commission have in developing, approving, or reviewing decisions to modernize and realign postal services? What input should postmasters and other postal employees, mailers, and the public have in these decisions?

- Accountability: What oversight mechanisms are needed to assure USPS decisions are consistent, transparent, and supported by reliable data? For example, are USPS's decisions on facility closures sufficiently transparent to the public?

The cost reduction proposals put forth by USPS offer options to help start USPS on a path—admittedly a long one at this point—to financial solvency. USPS is also looking at ways to enhance its revenue generation capabilities, including product enhancements, increasing market share in the parcel delivery market, and rate incentives. However, USPS has already discontinued FERS payments and has said that it is going to default by not making its mandated retiree health benefit payments at the end of this month. A projected default by USPS could increase risks to federal retirement and workers compensation programs and diminish USPS's trusted reputation and vital role in our economy, as well as the quality of postal services provided to the nation.

The stark reality is that USPS's business model is broken. The decline in mail volumes is continuing. The gap between revenues and expenses is growing. USPS cannot continue providing services at current levels without dramatic changes in its cost structure. Difficult choices must be made. Now is the time to decide USPS's future.

Chairman Lieberman, Ranking Member Collins, and Members of the Committee, this concludes my prepared statement. I would be pleased to answer any questions that you may have at this time.

GAO Contact and Staff Acknowledgments

For further information about this statement, please contact Phillip Herr at (202) 512-2834 or herrp@gao.gov. Contact points for our Congressional Relations and Public Affairs offices may be found on the last page of this statement. In addition to the contact named above, Frank Todisco, Chief Actuary; Susan Ragland; Teresa Anderson; Joshua Bartzen; Erin Cohen; John Dicken; Colin Fallon; Charles Ford; Kimberly Granger; Carol Henn; Shelby Kain; Hannah Laufe; Margaret McDavid; Kim McGatlin; Amrita Sen; and Crystal Wesco made important contributions to this statement.

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