UNITED STATES
POSTAL SERVICE

STATEMENT OF
POSTMASTER GENERAL/CEO PATRICK R. DONAHOE
BEFORE THE
SUBCOMMITTEE ON FEDERAL FINANCIAL MANAGEMENT, GOVERNMENT INFORMATION, FEDERAL SERVICES, AND INTERNATIONAL SECURITY
UNITED STATES SENATE

MAY 17, 2011

Good morning, Mr. Chairman and members of the subcommittee. I appreciate the opportunity to testify today on behalf of the U.S. Postal Service. Thank you for the invitation and thank you, Mr. Chairman, for calling this hearing to discuss our arrival at what we believe is a critical juncture in the Postal Service's long history.

Today, I will update you on our financial situation for the first half of fiscal year 2011, discuss the Postal Service's continued aggressive and targeted efforts to manage costs and grow our business, and examine pending legislative remedies; specifically your bill, Mr. Chairman. I also will describe to the subcommittee the realities of what we perceive as two distinct paths – down one of which the Postal Service will travel in the immediate future. The consequences of following either path depend in great measure on the actions taken by Congress before the end of this fiscal year, less than five months from now. Members of Congress have, from the first days of our nation's history, played an integral part in the creation, progress and viability of America's postal system. In 2011, the role of Congress in securing the future of the Postal Service is more critical than ever. We are truly at a crossroads. It is my responsibility to ensure that all Members have a full understanding of the gravity of the situation, and that they comprehend what may – or may not – happen if Congress fails to act.

The latest financial results, unfortunately, show continued struggles in both mail volume loss and revenue. In the first six months of this fiscal year, we experienced a net loss of $2.6 billion, compared to a $1.9 billion loss for the same period last year. In Quarter Two, total mail volume declined by nearly 1.3 billion pieces, or 3.0 percent over the same period last year. First-Class Mail has declined at an accelerated rate, surpassing previous projections. So far this year, First-Class Mail volume is down by 2.7 billion pieces, or 6.6 percent. These numbers represent the continued migration away from traditional hard-copy communications to electronic means of receiving information. Although advertising mail – also known as Standard Mail – has shown slight improvement in total volume, this mail generates far less in profits than First-Class Mail, and the slight increases failed to offset the continuing First-Class Mail decline. The First-Class

Mail declines are driven mainly by customers making fewer bill payments by mail, companies sending out fewer hard-copy statements and financial institutions migrating to online transactions. The recent recession significantly sped up this trend. We expect this shift in the mix of mail to continue as the digital world expands and customer habits shift accordingly. Trends also continued to move downward for certain mail classes, such as Periodicals (newspapers and magazines), as consumers receive fewer hard-copy publications and increasingly utilize mobile devices to access information.

As sobering as these mail volume and revenue results are, however, they pale in comparison to the more immediate threat to our viability – the looming liquidity crisis that will come to a head at the end of this fiscal year, on September 30, 2011. Our financial projections predict a loss for this fiscal year of approximately $8.3 billion, before any non-cash adjustments to workers' compensation liabilities. This loss is compounded by the approaching limit of $15 billion in borrowing authority, which will be reached this year. We have two substantial payments due at or near the end of this fiscal year; a $5.5 billion payment to pre-fund Retiree Health Benefits (RHB) and a $1.2 billion payment to reimburse the Department of Labor for workers' compensation claims paid in 2011.

Without changes in these unfunded federal mandates, the Postal Service will be unable to meet all of its financial obligations and will default on payments due to the Federal government this fiscal year.

The Postal Service is committed to satisfying our core mission — delivering America's mail. That is an imperative. To do this, we must pay our employees and our suppliers. But it must be understood that, absent legislative action, the Postal Service is certain to default on these substantial payments. This is clearly not the outcome we would choose, but without Congressional involvement, the result is unavoidable.

Mr. Chairman, absent mandates imposed by law, which place a unique financial burden on the Postal Service, we would have been operating in the black, despite crushing volume and revenue losses. We have gone to great lengths to offset the effects of both the economic recession and the digital revolution. For over a decade, we have aggressively sought to effectively manage and control those factors over which we have direct responsibility. Some examples of our efforts include:

- Reducing our total cost line by $12 billion over the last 3 ½ years.
- Development of our March 2, 2010 Comprehensive Strategic Plan to identify future trends and close the gap between future revenue and costs, using a variety of techniques.

- Eliminating 30 to 40 million work hours this year; adding to reductions totaling 240 million hours in the previous three years.
- Reducing the number of career employees to 571,566 at the close of Quarter Two; for a decrease of 113,208 employees since 2007 and a total reduction of over 200,000 employees in the last ten years, without layoffs.
- Undertaking an organizational redesign that will further streamline our work force by reducing 7,500 administrative positions.
- Reaching an historic agreement with the American Postal Workers Union (APWU) that will enhance workforce and work hour flexibility.
- Continuing to adjust our retail, mail processing and delivery networks by consolidating Post Offices, conducting Area Mail Processing (AMP) studies and realigning delivery routes.
- Creation of dozens of new products and services, designed to grow volume and revenue; including the Flat Rate Priority Box, Forever stamps, Every Door Direct Mail, Click-N-Ship, kiosks, digital apps and expanded access with retail partners like Office Depot.

Our nation has entered an era of heightened fiscal awareness; one that demands more streamlined and efficient government operations. The Postal Service serves as a model of such efficiency. Our relentless focus on managing costs, on right-sizing our retail and mail processing networks, and on better aligning our resources with the rapidly changing type and volume of mail has brought results any CEO would be proud to claim – and I am. I cannot adequately express how proud I am of each and every person in our organization for their tireless efforts to bring needed change to our organization, all while continuing to provide service that is second-to-none. But we have reached the point where our efforts alone are not enough to sustain the Postal Service. It is time for Congress to act.

Just as the mailing habits of the American people have changed over the last decade, just as the Postal Service has changed, so must existing law be changed. As noted above, the reasons behind the Postal Service's ongoing financial struggles are primarily due to matters other than declining mail volume and digital communication. One of the biggest challenges we face is the onerous burden of fulfilling pre-payments for Retiree Health Benefits, as set forth in the *Postal Accountability and Enhancement Act (PAEA)*. The PAEA, although well intentioned, was formed and brought to fruition in a very different world. In 2006, mail volume hit an all-time peak of 213 billion pieces. Gas prices had yet to spike and the recession was still around the corner. In 2007, fuel prices skyrocketed, the financial services sector began to contract and, as the economy went into a tailspin, mail volume began to plummet. As economic conditions worsened, the Postal Service was faced with a requirement to pay approximately $5.5 billion per year into the RHB Fund. What seemed possible in the years preceding enactment of PAEA – making this hefty annual payment on an extremely aggressive ten-year timetable - is now virtually assured of bringing the Postal Service to the brink of insolvency.

Many people, including members of this committee, worked on PAEA for many years. That effort does not go unnoticed or unappreciated. However, parts of that law have become an impediment to the Postal Service's financial stability. One need only look at our financial performance just prior to enactment of PAEA to see how the requirement to pre-fund RHB has put a stranglehold on Postal finances. In the four years preceding enactment of PAEA (2003-2006) the Postal Service had cumulative profits of $9.3 billion and generated sufficient cash to pay down $9.0 billion of debt. In the four years after PAEA was enacted (2007-2010), the Postal Service had cumulative losses of $20 billion and increased its debt by $9.9 billion while paying $21 billion to pre-fund RHB. Without the pre-funding, the Postal Service would have had a cumulative net income of $1 billion over the four years and $9 billion of cash in the bank.

The results above for fiscal year 2009 would have been even worse, except for enactment of Public Law 111-68, which deferred the required payment to the Postal Service RHB Fund by $4 billion. That change, while appreciated, was only a short-term, one-year fix and did not address the larger issues of continued future payments to the RHB Fund. No such exception was made for the fiscal year 2010 pre-payment of $5.5 billion, significantly contributing to a net loss of $8.5 billion for the year. And here we are again in fiscal year 2011, still without a long-term solution. It is clear that additional short-term fixes will no longer suffice.

Let me make clear that the Postal Service is in no way advocating changes that would endanger the future pension or health care benefits of our employees. We have always met and, in fact, have exceeded, funding amounts for future financial obligations to our employees. Currently, we have funded 47 percent of our total RHB obligations, with over $42 billion on deposit with the Treasury. Unlike most other employers, the Postal Service has set aside substantial amounts of cash for its retirement obligations. According to independent actuaries, the Postal Service has overpaid its Civil Service Retirement System (CSRS) pension obligations by $50-$75 billion. We have also overfunded Federal Employees' Retirement System (FERS) benefits by an additional $6.9 billion. Solutions exist that would allow the Postal Service access to the excess funds we have paid for CSRS and FERS. But such solutions can only be brought about through Congressional action. These are areas over which the Postal Service has no control.

We have, however, continually focused on all aspects of our operations over which we have sole responsibility. Our March 2, 2010 Comprehensive Strategic Plan was based on identifying and differentiating between those areas we alone must manage and those that lie outside the scope of our authority. The plan looked ten years into the future and, based on projections about mail volume and revenue, the Postal Service formulated a strategic plan to meet the challenges of the coming decade. We identified potential losses totaling $238 billion by 2020. We specified a set of actions that addressed a $123 billion gap consisting of areas of our operations over which we have control. Another key part of that plan included calling on Congress to enact measures that would free the Postal Service to secure its future now and for decades to come. Action on these measures is needed now. Actions Congress must undertake this year include:

- Resolve the RHB pre-funding requirement (both long and short term).
- Solve the inequities present in the current CSRS pension methodology.
- Repay the FERS overfunding of $6.9 billion.
- Permit the Postal Service to move to a five-day delivery model.
- Allow the Postal Service to make decisions more quickly and in a more business-like fashion regarding its retail facility and mail processing networks.

Failure of Congress to act will have a significant impact on a number of our stakeholders and on the economy of our nation as a whole. Threats to our liquidity and the consequences of defaulting on payments extend to a wide array of stakeholders. Constant negative discussions about the Postal Service's financial condition have a significant affect on our brand – a brand that is recognized, respected and valued by millions of people. The Postal Service is the cornerstone of an industry that employs over seven million Americans. Mail service providers, fulfillment companies, shipping firms, printers, transportation companies, and "Mom-and-Pop" small business owners all combine to use the mail and generate over $1 trillion in sales and revenue for the nation's economy. This important segment of the business world represents seven percent of the total Gross Domestic Product (GDP) in America. If Congress does not act now, it will have far more serious issues to address when the Postal Service is unable to pay its employees and suppliers and cannot move the mail.

At this critical point in our history, the Postal Service sees two distinct paths ahead. Which path we take and the outcome directly depends on the actions taken by Congress. In the first example, the Postal Service continues its aggressive cost-cutting strategies, trimming work hours and streamlining our work force to reach the optimal number of employees needed for present-day mail volumes. We continue to work closely with our labor unions to secure meaningful and responsible agreements. We mirror those actions in consultation with our management organizations. We continue efforts to right-size our network by carefully evaluating Post Office locations, mail processing plants and transportation to better match our resources with mail volume and operational needs. And we continue to build on the success of innovative ideas such as the Flat Rate box, Forever stamps, online services, digital applications, and expanded access points so customers can have postal services available when, where and how they want.

Meanwhile, Congress takes up comprehensive and long-term solutions, allowing the Postal Service to access amounts overpaid into FERS and CSRS. This use of funds allows the Postal Service to fully fund its RHB obligation and ensures adequate funding of both its pension systems. The Postal Service is given delivery flexibility, thus saving an additional $3.1 billion per year. We continue delivering the mail, we pay employees, suppliers and contractors, and we make needed capital investments. The mailing industry continues to thrive as the value of the mail is enhanced, and the Postal Service continues its key role as a profitable platform for commerce and the best postal system in the world.

The second path starts out exactly as the first. The Postal Service continues its aggressive cost-cutting strategies and follows all previous attempts to save work hours, negotiate meaningful and innovative contracts with our unions, balance work load with resources, and streamline its network of postal retail facilities, processing plants, and transportation. We match these efforts with continued innovations in technology, products and services as we continue to reinforce the value of the mail.

However, in the second scenario, even as the Postal Service continues its relentless focus on improvement, Congress fails to enact measures for FY 2011. Before the end of FY 2011, the Postal Service begins to default on payments to the Federal government as a means to conserve cash and continue operations at optimum levels for as long as possible. At the close of the fiscal year, on September 30, 2011, the Postal Service is forced to default on its payment to the Treasury for pre-funding of RHB. We reach the limits of our $15 billion debt ceiling and experience a cash shortfall. As we struggle to maintain liquidity, FY 2012 brings further mail volume and revenue declines. With no remaining borrowing authority, at some point in FY 2012, the Postal Service easily reaches a point where making payroll is no longer possible. Unable to pay our employees or suppliers, we are forced to cut back service. We cannot afford fuel for delivery vehicles and lack resources to operate our facilities. Unable to support our infrastructure, the mail delivery system grinds to a halt. No mail is collected or delivered, resulting in serious repercussions throughout the mailing industry, ultimately leading to million-dollar losses for thousands of companies and lost jobs, wages, and benefits for millions of workers. These results take a significant toll on an already shaky economy.

Please understand that the second example is not an exaggeration. Such an occurrence is entirely within the realm of possibility, if Congress does not act. We continue to analyze our financial forecasts, especially as revenue levels were disappointing for the second quarter and the trends have continued through April and into May. The five-year forecasts submitted to Congress in April, carried the caveat of being based on our Integrated Financial Plan, developed last fall. The most recent financial forecasts, which were reviewed by the Board of Governors last week, show a deteriorating mail volume and revenue trend that exacerbates our solvency crisis. Attached are our latest forecasts for 2011 and 2012 showing income and cash / debt positions without and with our proposed legislative changes. Unfortunately, satisfying the pre-funding of RHB with CSRS overpayments does not provide enough liquidity, on its own, to see us through the month of October when we are scheduled to pay $1.2 billion to the Department of Labor for workers' compensation costs. This underscores the need for the additional measures of repaying the FERS overfunding and allowing the implementation of five-day delivery. The Postal Service has also carefully evaluated the effects of these legislative changes for the next five years. The cumulative effects of legislation to address FERS, RHB pre-funding, CSRS overpayments, and five-day delivery, amount to $46 billion over the next five years. Pre-funding of RHB alone represents about half of these total savings. Returning the Postal Service to profitability is within reach, but it will require comprehensive legislation by Congress.

We stress long-term solutions because, even if stopgap measures are enacted to ensure continuation of mail delivery operations, without meaningful and far-reaching legislation, other aspects of our operations will continue to struggle. Mr. Chairman, you referred to a Government Accountability Office (GAO) report on the Postal Service's vehicle fleet, which points out the costs associated with maintaining an aging fleet of over 200,000 delivery vehicles. Our vehicles are, on average, 25 years old. The GAO report recommends that the Postal Service develop plans to address its vehicle fleet needs. Such plans, of course, require a substantial capital investment approaching $7 billion, which the Postal Service simply does not have. We realize, and the GAO notes, that repairing our delivery trucks and vans is a temporary measure at best and does not provide a permanent solution to our future vehicle needs.

Enactment of legislation this year would not only address RHB payments, pension obligations and liquidity concerns, but it would give the Postal Service enhanced financial flexibility to make capital investments for critical needs, such as vehicle replacement. Even with our limited resources, the Postal Service has researched and tested a variety of alternative fuel vehicles and we remain eager to explore ways to save fuel and protect the environment. But we are hindered by the realities of our financial situation. Like any business, we have the will and the desire to make these kinds of operational improvements, but without action from Congress, capital investment is an expenditure we simply cannot afford.

Fortunately, there are proposals on the table which will help us. You, Mr. Chairman, have just introduced a bill that we believe would go a long way toward improving the Postal Service's financial situation. Specifically, your bill seeks to address the CSRS issue by requiring the Office of Personnel Management (OPM) to use current actuarial practices to determine if a CSRS surplus exists and, if so, to allow for the transfer of any surplus to the RHB Fund to satisfy the annual pre-payment amount. It would also allow us to access the FERS over-funding for RHB. It would make needed adjustments to the PAEA to provide for continued and regular transfers of surplus amounts to the RHB fund every five years.

The bill would give the Postal Service the authority to shift to a five-day delivery model, thus saving in excess of $3 billion per year. It would give us enhanced ability to consider the consolidation or closure of Post Offices and would allow for greater latitude in partnering with local businesses to ensure the continued availability of postal services in the communities we serve. We would be free to explore a greater variety of non-Postal offerings and would be able to partner more fully and easily with state and local governmental entities. Arbitrators would be required to take into consideration the financial health of the Postal Service when rendering decisions about collective bargaining. We could realize a significant increase in revenue by being permitted to handle the mailing of beer and wine. Your legislation takes a wide-ranging approach to solving the many issues involving the Postal Service and would play a significant part in returning the Postal Service to profitability.

We also appreciate Senator Collins' bill that would address the same issues involving CSRS and FERS surpluses and pre-funding of RHB, among other provisions. Members of the House have also introduced measures designed to resolve these critical legacy cost issues. We are extremely grateful for these proposed measures and it is our hope that they will progress swiftly through the legislative process. A failure to move these bills virtually assures that the second scenario detailed earlier will come to pass.

Although our focus is chiefly on Postal Service finances and our future, it is important to remember that the negative affects of taking the second path will not be limited to the Postal Service. The mailing industry is a crucial driver of our nation's economy, generating over $1 trillion each year and employing more than seven million people. The most recent mailing industry study shows that the impact of the Postal Service on the economy is much larger than what is reflected in our own financial results. In fact, the Postal Service — as we continue to downsize our workforce and streamline our operations — represents only about 8.3 percent of the total jobs in the mailing industry. Over 90 percent of the workers in the mailing industry are employed outside the Postal Service. A healthy, profitable and thriving Postal Service is necessary not just to preserve Postal jobs, but to protect private sector employees and businesses.

Only two weeks ago, I attended the National Postal Forum in San Diego, CA. This annual gathering brings together a true cross-section of the mailing world; large mailers, medium-sized companies, small business owners, and the many suppliers of technology and service to the mailing industry. We engaged in a variety of activities, including workshops, networking and educational programs, all geared toward a singular focus on growing the use of the mail. But you cannot achieve success without a clearly defined and articulated plan. I outlined for attendees our four business strategies, designed to help us further define, improve and hone our core function – delivering the mail. These four strategies were introduced as a complement to our March 2, 2010 Comprehensive Strategic Plan for the Future. Using these principles, the Postal Service will ensure future growth. Our guiding principles are:

- Strengthening the Business to Consumer Channel
- Improving the Customer Experience
- Competing for Package Business
- Continuing to become a Leaner, Faster and Smarter organization

The 21st century Postal Service will be a more market-responsive organization. As we focus on perfecting our core mission of delivering the mail, we will continue to promote the mail as a unique form of communication. We will enhance our efforts to educate businesses on the value of the personal touch only available through the mail. We plan to launch a major advertising campaign in September that will promote the use and value of the mail. We are looking at that 75 percent of the business world that currently does not use the mail and we will convince them, through incentives and special offerings, to give the mail a try. Going forward, the Postal Service will employ an integrated market strategy; one that combines the best of the digital world and the physical delivery of mail. We will continue our focus on making it simple and convenient to do business with us as we expand to include more alternate access sites. We plan to make changes in our permit system to further enhance the ease of doing business with the Postal Service. We will focus even more on our package business, capitalizing on the rise in e-commerce and the corresponding returns business.

For years, the Postal Service has been given a wide array of mandates and recommendations from myriad entities, including Congress, the GAO, the Postal Regulatory Commission (PRC), various Administrations and the President's Commission on the Postal Service, to name just a few. Virtually all of these mandates begin with the concept of the Postal Service operating more like a business. That has been, and will continue to be, our focus and our aim. With the continued evolution of communications in our nation, we cannot be a static, fixed government entity. We must continue to change with the pulse of the nation, and part of that change is continually reevaluating what kind of services we provide, where we provide them, and how customers gain access to them. The old philosophy — of a Post Office for every community, regardless of size, a Postmaster for every facility, regardless of demand, and a Postal Service that functions as the de facto government representative in every city, town and hamlet — is fading. If the nation wants to preserve its postal system, it must allow that system to adapt to the changing world.

As I noted earlier, the Postal Service will continue to seek out ways to improve our core business of delivering the mail, promote and grow the use of mail for businesses large and small, make it easy and convenient for people to do business with us, and find innovative ways to continue providing the services our customers demand and expect. Our mission and our strategies will not change. But there are issues which remain out of our control and we look to Congress to act on these. The future of the Postal Service is at stake, certainly, but a huge portion of the nation's economy is also at risk. We have tried to clearly lay out the future and ensure Congress understands the consequences of a failure to take appropriate action.

We appreciate the continued support and efforts of you, Mr. Chairman, and other Senators, as well as House members. We are truly at a defining moment in the history of the Postal Service. We know the outcome that is needed by the Postal Service and the one that is needed by our business partners, employees, unions, management organizations and the Americans we serve. No one wants to see our mail system falter, but without some resolution from Congress, that is precisely what lies ahead. Working together, we can avoid these dire consequences and continue to be the world's best example of a modern, relevant, and profitable postal system. Thank you and I look forward to answering your questions.

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2011-2012 Forecasts

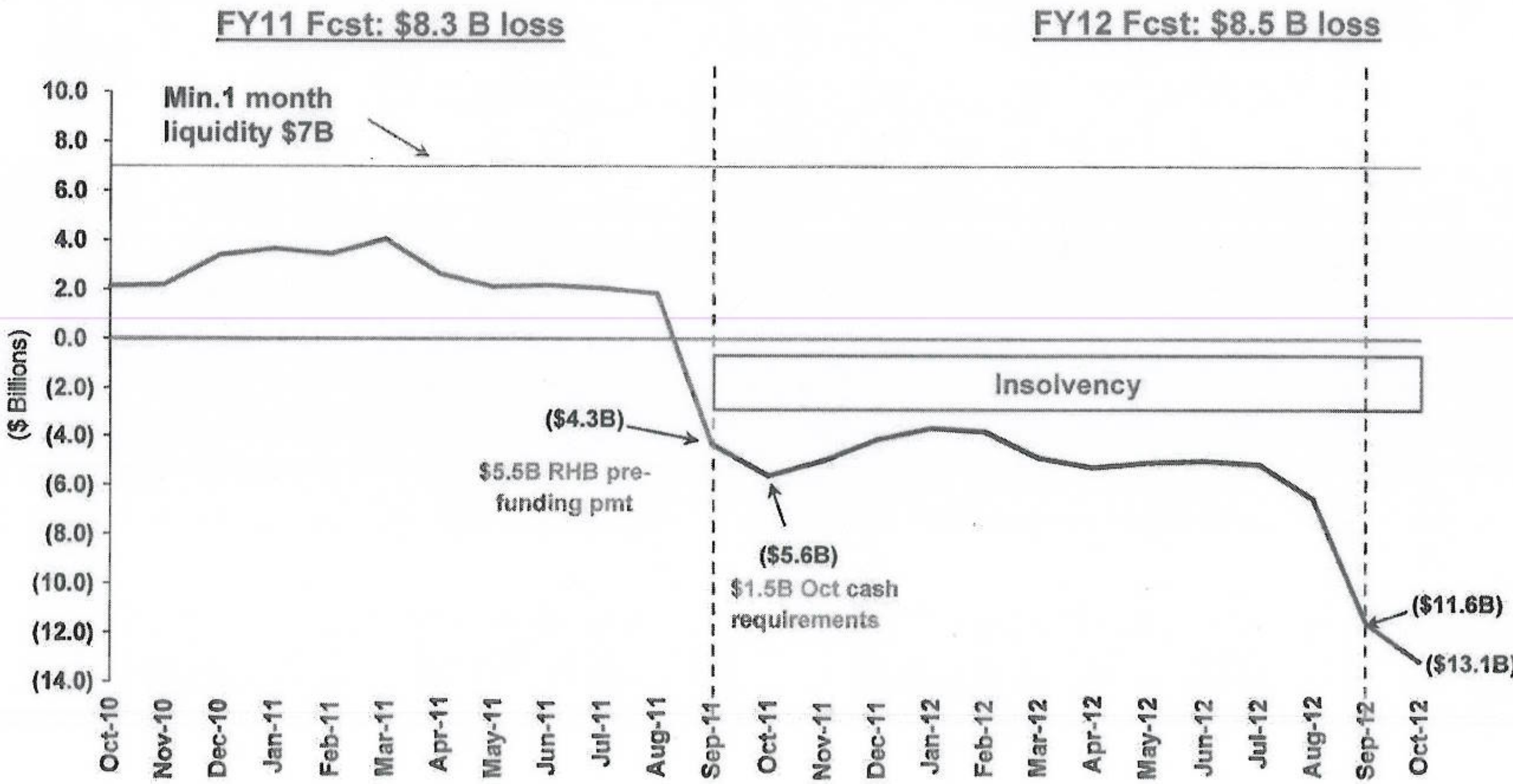
US Dollars in Billions	2011 IFP	2011 (Forecasts)	2012 (Forecasts)
Mail Volume (pieces)	173	168	165
Revenue	67.7	65.5	65.5
Expenses (Net of $1.7B Add'l Mgmt Action Effects in '12)	(68.6)	(68.3)	(68.4)
Op. Income (Loss) before RHB	**(0.9)**	**(2.8)**	**(2.9)**
RHB Pre-Funding	(5.5)	(5.5)	(5.6)
Net Income (Loss) Before Legislative Changes	**(6.4)**	**(8.3)**	**(8.5)**
Net (Debt) / Cash Before Legislative Changes	**(17.7)**	**(19.3)**	**(26.6)**
Legislative Changes - USPS Proposal:			
FERS Refund (lump sums received Sept 30, 2011 and 2012)		3.0	3.9
Five-Day Delivery (commences March 2012 & net of start-up costs)		-	1.0
RHB Pre-Funding Satisfied (with CSRS overpayment or Pay-As-You-Go or IG's 30% funding)		5.5	5.6
Interest Savings from Legislative Changes		-	0.3
Net Income (Loss) After Legislative Changes		**0.2**	**2.3**
Net (Debt) / Cash After Legislative Changes		**(10.8)**	**(7.3)**

$15 Billion Debt Limit

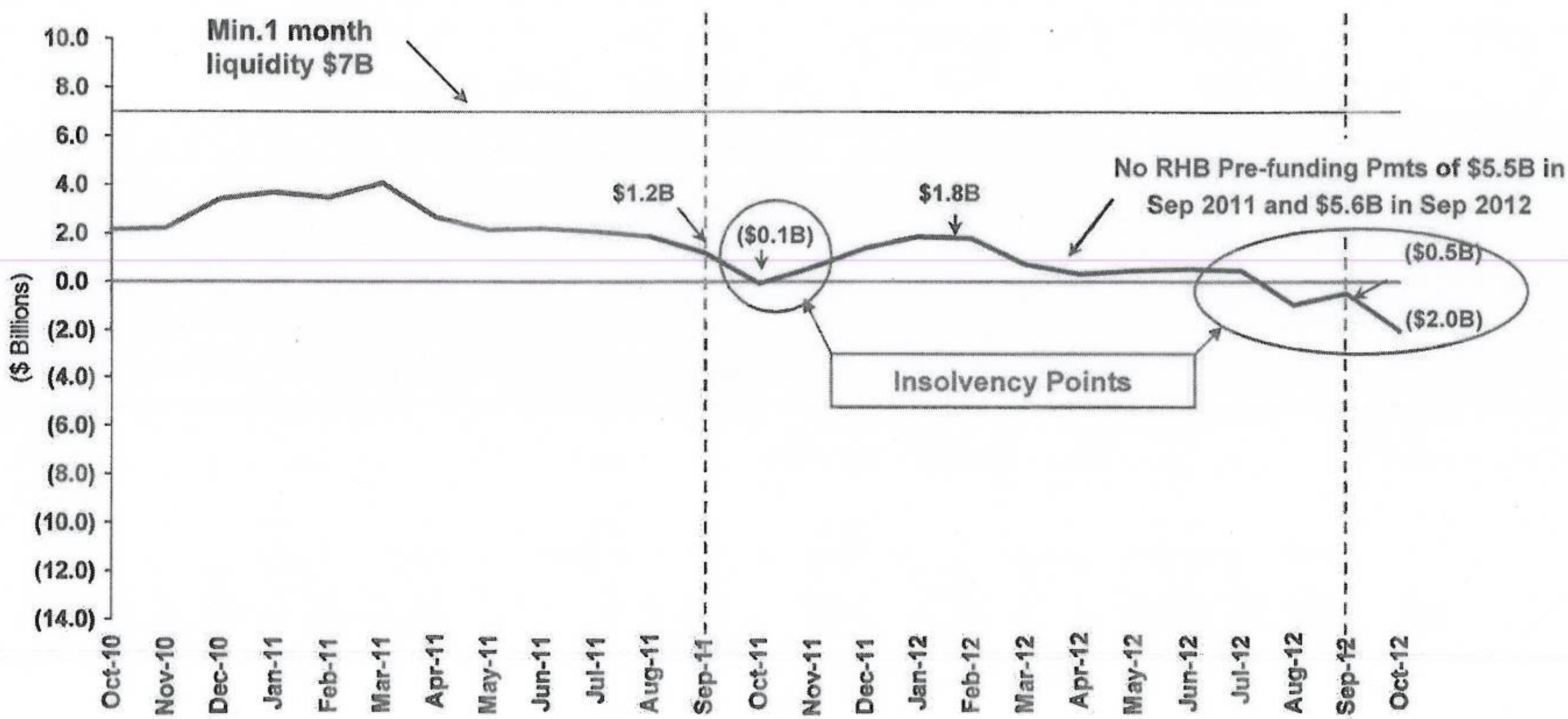
Notes for P/L and Cash Forecasts:

- Excludes Non-cash Adjustments to Workers' Compensation Liabilities; may impact net income but not near-term cash flows.

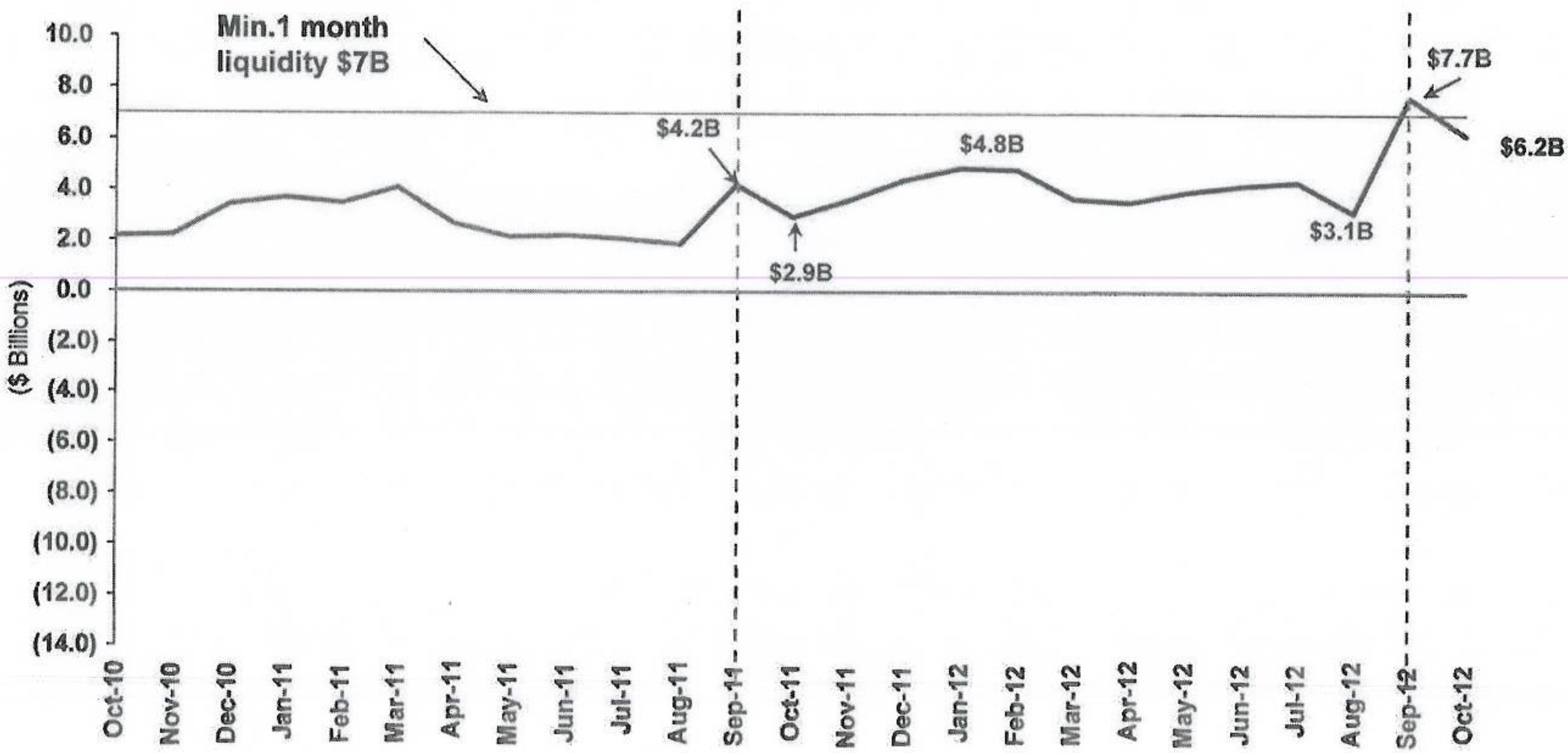
Available Liquidity at Month-End: No Legislative Changes



Available Liquidity at Month-End: No RHB Pre-Funding Payments



Available Liquidity at Month-End:
USPS Legislative Proposal Completed
No RHB Pre-Funding Payments, FERS Refund & Five-Day Delivery



UNITED STATES
POSTAL SERVICE

Patrick R. Donahoe
Postmaster General and Chief Executive Officer

Patrick R. Donahoe was named the 73rd Postmaster General of the United States of America on October 25, 2010. A 35-year postal veteran, he reports to the Postal Service Board of Governors.

Prior to being named Postmaster General, Donahoe served as the 19th deputy postmaster general – the second highest-ranking postal official – and chief operating officer. In his dual roles, Donahoe had responsibility for the day-to-day activities of 574,000 career employees working in more than 33,000 facilities supported by a fleet of nearly 219,000 vehicles. Additionally, he was responsible for mail processing, transportation, field operations, engineering, delivery, retail, facilities and network operations.

As chief operating officer, Donahoe was instrumental in the Postal Service achieving record levels of service and customer satisfaction, significant workplace improvements and a cumulative increase of productivity of over 8 percent since 2001, including seven straight years of productivity gains. The Postal Service has annual revenues of $68 billion and delivers nearly half the world's mail.

Donahoe entered the Postal Service as a clerk in Pittsburgh, PA, and has had a long and distinguished career in postal operations. His previous officer positions include chief operating officer and executive vice president, senior vice president of Operations, senior vice president of Human Resources and vice president of Allegheny Area Operations.

Donahoe earned a Bachelor of Science degree in economics from the University of Pittsburgh and a Master of Science degree as a Sloan Fellow at the Massachusetts Institute of Technology.

A native of Pittsburgh, Donahoe and his wife have two children.

March 2011

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