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U.S. POSTAL SERVICE

Restructuring Urgently Needed to Achieve Financial Viability

Statement of Phillip Herr, Director
Physical Infrastructure Issues

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Highlights

Highlights of GAO-09-958T, a testimony before the Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security, Committee on Homeland Security and Governmental Affairs, U.S. Senate

U.S. POSTAL SERVICE

Restructuring Urgently Needed to Achieve Financial Viability

Why GAO Did This Study

The U.S. Postal Service's (USPS) financial condition has worsened since GAO testified before this Subcommittee last January, with the recession and changing mail use causing dramatic declines in mail volume and revenues despite postal rate increases. USPS expects these declines to lead to losses and cash shortfalls even if ambitious cost-cutting is achieved.

Mail use has been changing over the past decade as businesses and consumers have moved to electronic communication and payment alternatives. Mail volume peaked in 2006, and USPS expects that much of the lost volume will not return after the recession is over.

USPS's business model has relied on growth in mail volume to cover costs, but USPS has not been able to cut costs fast enough to offset the accelerated decline in mail volume and revenue. Thus, GAO added USPS's financial condition to the High-Risk List in July 2009.

This testimony (1) updates USPS's financial condition and outlook and explains GAO's decision to place USPS's financial condition on the High-Risk List and (2) discusses the need for USPS to restructure and presents options and actions that USPS can take. It is based on GAO's past and ongoing work.

View GAO-09-958T or key components. For more information, contact Phillip Herr at (202) 512-2834 or herrp@gao.gov.

What GAO Found

USPS's financial condition and outlook continue to deteriorate with a worsening outlook for mail volume and revenue. USPS now projects mail volume to decline to 175 billion pieces in fiscal year 2009, a 13.7 percent decrease from fiscal year 2008. As a result, USPS projects for fiscal year 2009:

- a net loss of $7 billion, even if it achieves record savings of more than $6 billion;
- an increase in outstanding debt to a total of $10.2 billion; and,
- despite this borrowing, an unprecedented $1 billion cash shortfall.

Thus, USPS expects to generate insufficient cash to fully make its mandated payment of $5.4 billion for future retiree health benefits due by September 30, 2009.

When GAO added USPS's financial condition to its high-risk list, it reported that USPS urgently needs to restructure to address its current and long-term financial viability. The short-term challenge for USPS is to cut costs quickly enough to offset the unprecedented volume and revenue declines, so that it can cover its operating expenses. The long-term challenge is to restructure USPS operations, networks, and workforce to reflect changes in mail volume, use of the mail, and revenue. Accordingly, GAO called for USPS to develop and implement a broad restructuring plan—with input from the Postal Regulatory Commission and other stakeholders and approval by Congress and the administration—that includes key milestones, time frames for actions, identifies what steps Congress and other stakeholders may need to take, and addresses how USPS plans to:

- realign postal services, such as delivery frequency, delivery standards, and access to retail services, with changes in the use of mail by consumers and businesses;
- better align costs and revenues, including compensation and benefit costs;
- optimize its operations, networks, and workforce;
- increase mail volumes and revenues; and
- retain earnings, so that it can finance needed capital investments and repay its growing debt.

To achieve financial viability, USPS must align its costs with revenues, generate sufficient earnings to finance capital investment, and manage its debt. Key restructuring actions that USPS could take include the following:

- reduce compensation and benefit costs,
- consolidate retail and processing networks and field structure, and
- generate revenue through new or enhanced products.

USPS has proposed two actions that would require congressional approval: 1) changing funding requirements for retiree health benefits and 2) reducing mail delivery from 6 to 5 days. USPS's financial viability is critical as it plays a vital role in the U.S. economy and in providing postal services to all communities.

Mr. Chairman and Members of the Subcommittee:

I am pleased to participate in this hearing on the U.S. Postal Service's (USPS) financial condition. My statement will (1) provide updated information on USPS's financial condition and outlook and explain our recent decision to place USPS's financial condition on our High-Risk List and (2) discuss the need for USPS to restructure and present options and actions USPS can take to address both its current and its long-term challenges.

My statement is based upon on our past and ongoing work, including our report adding USPS to our High-Risk List,[1] and our continued monitoring of USPS's financial condition and outlook. We conducted our work for this statement from May 2009 to August 2009 in accordance with all sections of GAO's quality assurance framework that are relevant to our objectives. The framework requires that we plan and perform the engagement to obtain sufficient and appropriate evidence to meet our stated objectives and to discuss any limitations in our work. We believe that the information and data obtained, and the analysis conducted, provide a reasonable basis for any findings and conclusions in this product.

USPS's Financial Condition Continues to Deteriorate, and We Have Added Its Financial Condition to Our High-Risk List

USPS's financial condition and outlook have continued to deteriorate since I testified before this Subcommittee last January, as the prospects for both mail volume and revenue worsen. USPS currently projects fiscal year 2009 mail volumes of about 175 billion, which would be 28 billion fewer pieces than fiscal year 2008. This 13.7 percent decline, triple the 4.5 percent decline for fiscal year 2008, would be the largest percentage decline since the Great Depression. As a result, USPS is projecting the following for fiscal year 2009:

- a net loss of about $7 billion, even if USPS achieves record cost savings of about $6 billion;
- an increase in outstanding debt to a total of $10.2 billion; and
- despite this borrowing, an unprecedented $1 billion cash shortfall.

USPS has reported that it does not expect to generate sufficient cash from operations to fully make its mandated fiscal year 2009 payment of $5.4

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

billion for future retiree health benefits that is due by September 30, 2009–even if it receives legislative relief from these payments.

USPS also expects continued financial problems in fiscal year 2010 (see table 1), including a similar deficit and a larger cash shortfall, even if it achieves larger cost savings. Under this scenario, USPS would increase its outstanding debt by an additional $3 billion, which would bring its total debt to $13.2 billion at the end of fiscal year 2010—only $1.8 billion less than its $15 billion statutory limit.[2]

Table 1: USPS's Financial Results and Projections, Fiscal Years 2006 through 2010

Dollars in billions

Fiscal year	Net income (loss)	Year-end cash	Year-end debt
2006	$0.9	1.0	2.1
2007	(5.1)	0.9	4.2
2008	(2.8)	1.4	7.2
2009 (projected)	(7.0)	(1.0)	10.2
2010 (projected)	(7.0)	(4.5)	13.2

Source: USPS.

Note: Cash projections assume cost savings of $5.9 billion in 2009 and $8 billion in 2010 and no relief from retiree health benefits payments.

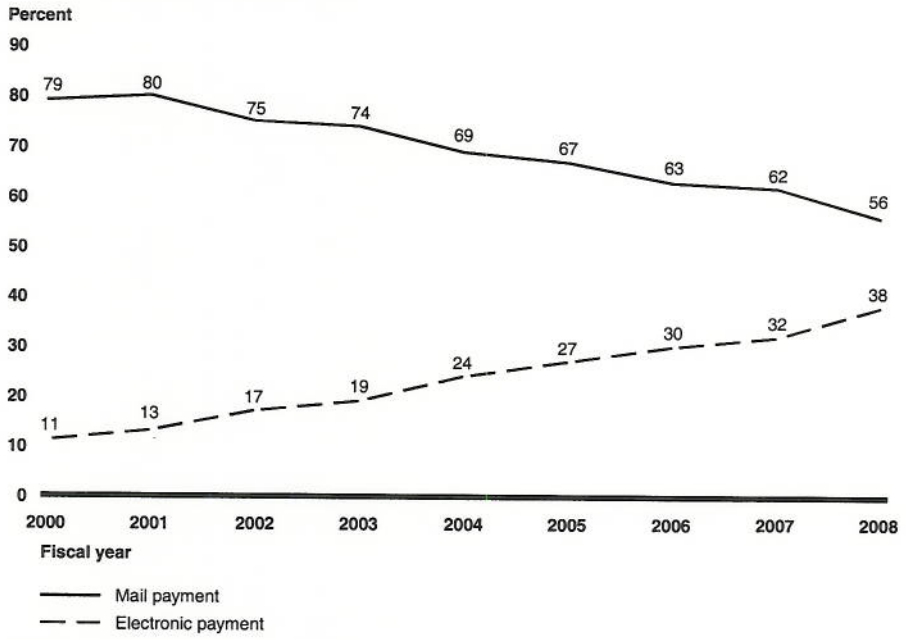
USPS's projected cost cutting of about $6 billion for this fiscal year is much larger than its previous annual cost-cutting targets, which have ranged from nearly $900 million to $2 billion since 2001. However, USPS projects cash shortfalls because cost cutting and rate increases will not fully offset the impact of mail volume declines and other factors that increase costs—notably semiannual cost-of-living allowances (COLA) for employees covered by collective bargaining agreements. Compensation and benefits constitute close to 80 percent of USPS's costs—a percentage that has remained similar over the years despite major advances in technology and the automation of postal operations. Also, USPS continues to pay a higher share of employee health benefit premiums than other federal agencies. Finally, USPS has high overhead (institutional) costs that are hard to change in the short term, such as the costs of providing universal service with 6-day delivery, a network of 37,000 post offices and retail facilities, and a delivery network of more than 149 million addresses.

[2]39 U.S.C. § 2005(a).

Last week, we added USPS's financial condition to the list of high-risk areas needing attention by Congress and the executive branch to achieve broad-based transformation. We reported that USPS urgently needs to restructure to address its current and long-term financial viability. USPS has not cut its cost structure fast enough to offset accelerated declines in mail volume and revenue. To achieve financial viability, USPS must align its costs with revenues, generate sufficient earnings to finance capital investment, and manage its debt.

We also noted that mail use has been changing over the past decade as businesses and consumers have moved to electronic communication and payment alternatives. For example, the percentage of household bills paid by mail is declining while the percentage paid electronically is increasing (see fig. 1). Mail volume peaked in 2006, and its decline has accelerated with the economic recession, particularly among major mail users in the advertising, financial, and housing sectors. Mail volume has typically returned after recessions, but USPS's 5-year forecast suggests that much of the lost volume will not return.

Figure 1: Percentage of Household Bill Payments Made by Mail and Electronically, Fiscal Years 2000 through 2008



Source: USPS.

Addressing USPS's financial viability is critical because USPS plays a vital role in the U.S. economy and provides postal services to all communities. Moreover, it is the largest civilian federal agency, employing about 633,000 career and 94,000 noncareer employees and operating a total of about 38,000 facilities nationwide.

USPS has had difficulty reducing costs in two areas because of limited flexibility. First, as we have testified, USPS needs to make changes to its compensation and benefits, which compose about 80 percent of its costs. To do so, USPS will need to negotiate with its four largest unions on collective bargaining agreements that will expire in 2010 and 2011. These agreements cover about 85 percent of postal employees and include items such as cost-of-living adjustments, work rules, and layoff protections. USPS will also need to consult on compensation and benefits with three management associations representing most of its other employees. USPS has a window of opportunity to reduce the cost and size of its workforce through attrition and a large number of upcoming retirements, thereby also minimizing the potential for layoffs.

Second, as we have also testified, USPS needs to optimize its retail, mail processing, and delivery networks to eliminate growing excess capacity and maintenance backlogs, reduce costs, and improve efficiency. USPS has made limited progress in optimizing its networks and must work with employees, local communities, and others affected by these changes to address resistance to closing and consolidating facilities.

Broad Restructuring Needed to Help USPS Achieve Financial Viability

USPS needs to address weaknesses in its business model, which has relied on growth in mail volume to cover costs and enable USPS to be self-supporting. Despite increasingly ambitious cost-cutting efforts, USPS has not been able to cut costs fast enough to offset the accelerating declines in mail volume and revenue. For these reasons, we concluded that restructuring action is needed in multiple areas, including possible action and support by Congress, since no single change will be sufficient to address USPS's challenges.

- The short-term challenge for USPS is to cut costs quickly enough to offset the unprecedented volume and revenue declines, so that it can cover its operating expenses.
- The long-term challenge is to restructure USPS's operations, networks, and workforce to reflect changes in mail volume, use of the mail, and revenue.

We also identified key restructuring options and actions USPS could take, including the following:

1. Reduce compensation and benefit costs through

- *retirements*: About 162,000 USPS employees are eligible to retire this year, and this number will increase to almost 300,000 within the next 4 years.
- *early retirements*: About 150,000 USPS employees were recently offered voluntary early retirement, but fewer than 3 percent accepted.
- *lower benefit costs*: USPS pays a higher percentage of employee health benefit premiums than other federal agencies (80 percent versus 72 percent, respectively). In addition, USPS pays 100 percent of employee life insurance premiums, while other federal agencies pay about 33 percent.

2. **Consolidate retail and processing networks**

- Remove excess capacity in USPS's mail processing network, where processing capacity for First-Class Mail exceeds needs by 50 percent.

- Maximize use of lower-cost retail alternatives: A growing amount of USPS's retail revenue comes through alternative channels—for example, stamps are sold by mail, on the Internet, and at grocery stores.

- Reduce the network of 37,000 retail facilities, where maintenance has been underfunded for years, resulting in deteriorating facilities and a maintenance backlog.

3. **Consolidate field structure:** Review the need for 74 district offices and 9 area offices.

4. **Generate revenue through new or enhanced products:** Use USPS's pricing and product flexibility to maximize profitable mail volume.

Other options and actions that USPS has proposed that would require congressional approval include the following:

1. **Change funding requirements for retiree health benefits**: USPS has asked Congress to revise the funding requirements for its retiree health benefit obligation as it does not expect to make the full amount of its $5.4 billion retiree health benefit payment at the end of this fiscal year because of a cash shortage.

2. **Realign delivery services with changing use of mail**: USPS has asked Congress to allow it to reduce delivery from 6 days to 5 days per week as revenue and mail volume have declined. Specifically, USPS's revenue per delivery has declined 20 percent from fiscal year 2000 to fiscal year 2009, paralleling a comparable decline in the number of mail pieces delivered per address.

Accordingly, we have called for USPS to develop and implement a broad restructuring plan—with input from the Postal Regulatory Commission and other stakeholders, and approval by Congress and the administration—that includes key milestones and time frames for actions, addresses key issues, and identifies what steps Congress and other stakeholders may need to take. We stated that the restructuring plan should address how USPS plans to

- realign postal services, such as delivery frequency, delivery standards, and access to retail services, with changes in the use of mail by consumers and businesses;
- better align costs and revenues, including compensation and benefit costs;
- optimize its operations, networks, and workforce;
- increase mail volumes and revenues; and
- retain earnings, so that it can finance needed capital investments and repay its growing debt.

In addition, GAO has initiated a review, as required by the Postal Accountability and Enhancement Act of 2006,[3] to evaluate these and other options and actions for the long-term structural and operational reforms of USPS.

Mr. Chairman, this concludes my prepared statement. I would be pleased to answer any questions that you or other Members of the Subcommittee may have.

GAO Contact and Staff Acknowledgments

For further information regarding this statement, please contact Phillip Herr at (202) 512-2834 or herrp@gao.gov. Individuals who made key contributions to this statement include Shirley Abel, Teresa Anderson, Gerald P. Barnes, Josh Bartzen, Elizabeth Eisenstadt, Paul Hobart, Kenneth E. John, Hannah Laufe, Josh Ormond, Travis Thomson, and Crystal Wesco.

[3]Pub. L. No. 109-435, § 710 (Dec. 20, 2006).

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