**TESTIMONY OF
JOHN E. POTTER, POSTMASTER GENERAL/CEO,
BEFORE A HEARING OF THE
COMMITTEE ON HOMELAND SECURITY
AND GOVERNMENTAL AFFAIRS
UNITED STATES SENATE
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Good afternoon, Chairman Collins and Committee members. I am pleased to be with you today as we continue the critical discussion about the need for comprehensive reform of the legislative framework governing the Postal Service.

We appreciate the Committee's leadership in hearing from a broad range of postal stakeholders as part of its work in attempting to develop reform legislation that protects universal service – our ability to provide quality, affordable, accessible mail service to every household and business in America.

That has been, and continues to be, the role of the United States Postal Service. And we are proud of that role. We are, perhaps, the most tangible daily link between the people of America and their government. Yet we are profoundly different from other government agencies. That's because postal operations are funded by the sale of postal products and services – not by tax dollars. In fact, the Postal Service is self supporting and has not received a public service appropriation since 1982, saving American taxpayers more than $11 billion, the amount authorized by law.

This has not always been the case. Until today's Postal Service was created in 1971, 18 percent of the annual costs of operating the former Post Office Department were paid by direct appropriations – tax dollars. A self-supporting Postal Service – one that has broken even over its 34-year history – is among the significant legacies of the landmark 1970 legislation that created today's Postal Service.

Our presence here today is a strong affirmation that we do not want to return to the days when America's mail system was dependent on an annual infusion of tax dollars to make ends meet. Yet, when I became Postmaster General in June 2001, that possibility – previously unthinkable – was not as implausible as it once seemed.

Just a few months earlier, the Government Accountability Office placed the Postal Service on its "High Risk List." The GAO cited a growing risk of our not being able to continue providing universal postal service, vital to the national economy, at reasonable rates, while remaining self supporting through postal revenues.

In a later Senate hearing on this subject, Comptroller General David M. Walker pointed out that only the Postal Service's governmental status provides insulation from the bankruptcy process that would be applicable to private sector companies in a similar situation.

Like Mr. Walker, our Board of Governors and Postal Service management recognize the difficult, long-term challenges facing the organization. We will be examining them in some depth today. We will be examining the considerable progress we have made in responding to those challenges through our Transformation Plan. We will also be examining the fundamental problems of our governing statute that are central to the GAO's "High Risk" designation.

To be fair, the Postal Reorganization Act of 1970 could not anticipate the development and widespread adoption of electronic communications or their effect on mail volume. The Act could not foresee the robust growth of a highly competitive private-sector delivery market, one that includes affiliates of foreign postal administrations. While the Act set the stage for three decades of success in serving America, it was the product of another time. As such, it also imposed the limitations that are at the heart of the situation we face today.

When we were placed on the “High Risk List,” the challenges were formidable. Mail volume was declining. From a high of almost 208 billion pieces in 2000, total volume fell by more than four billion pieces the following year. More significantly, we were starting to see volume erosion in high-margin First-Class Mail. By 2002, First-Class volume was down 1.2 billion pieces from the previous year.

Mail volume, to some extent, is a bellwether of broader economic trends. The declines we were experiencing certainly reflected a soft economy as well as the negative business effects of the terrorist attacks of the fall of 2001. However, it was also clear that the long-predicted electronic diversion was beginning.

At the same time, expenses were rising. Our delivery network – and its associated costs – continued to grow by about 1.8 million new addresses each year. In a standard business environment, yearly acquisition of this number of new customers would appear to be a growth opportunity. For the Postal Service, this is not the case. In an environment of declining, high-contribution First-Class Mail volume and expanding deliveries, this trend will continue. Simply put, we are delivering fewer pieces of mail to more addresses, placing severe pressure on our bottom line.

With expenses outpacing revenue, we experienced three consecutive years of net losses through 2002. Over that period, cumulative losses reached $2.6 billion.

Declining revenues required the maintenance of a strict freeze on capital spending for most facility projects. Capital commitments, which stood at $3.6 billion in 2000, were reduced to $1.9 billion by 2001, affecting the maintenance and modernization of our infrastructure of more than 37,000 postal facilities. However, we continued to invest in necessary life-safety systems and we invested in mail processing equipment and other projects that provided a positive return on investment.

By 2001, our debt had reached $11.3 billion, an increase of almost $2 billion from the previous year, and only $3.7 billion below our statutory debt limit. Servicing that debt resulted in costs of more than $300 million in 2001.

And, as estimated by the Government Accountability Office, the Postal Service's major liabilities and obligations were close to $100 billion. That included liabilities for annuities, workers' compensation benefits, debt, and other obligations for post-retirement benefits.

As we took stock of our financial situation, it was clear that we had to go beyond "business as usual." Our ability to continue successfully serving the nation would be dependent on our willingness and ability to transform and bring a new sense of urgency, focus and innovation to everything we did.

It was equally clear that our business model, established by the same 1970 law that created the Postal Service, was inadequate for the needs of today. Its assumption, that continually rising First-Class Mail volume would produce the revenue necessary to support a continually growing delivery network, was no longer valid.

When I became Postmaster General, there was broad consensus that structural reform of the laws governing the operation of the Postal Service was necessary. Indeed, Congress had taken some encouraging steps in that direction.

At the same time, we recognized the obligation of the Postal Service to push business effectiveness and operational efficiency to the limits permitted by current postal laws. We were encouraged in this direction by Congress and by the Government Accountability Office.

The result was our comprehensive Transformation Plan. With wide-ranging stakeholder input, we created the Plan to help us meet the challenges of long-term technological and commercial trends that are fundamentally reshaping the postal landscape here and throughout the world.

As the process of legislative reform continues, the Postal Service understands that it cannot relax its efforts. We must continually work to offer better value than ever. We must continue to offer a favorable return on our customers' investment. We must continue to offer ease of use. We must continue to offer the solutions our customers need. Above all, we must have the ability to offer attractive and affordable rates. This is why one of our key transformation strategies is fostering growth by continuing to increase the value of postal products and services to our customer.

To do that, we have challenged our managers to "think outside the box." And they have come through. They responded with creative approaches to pricing and to products. Across the entire organization – in every functional area – our people understood the need for change. They made implementation of our Transformation Plan their focus, and they delivered results.

Perhaps the best example is Negotiated Service Agreements, which provide pricing incentives for mailers to encourage more First-Class Mail volume, while reducing handling costs for the Postal Service. In just a single year, the first of these agreements produced a combination of $21.7 million in cost reductions and increased contribution from higher mail volume. To date, three financial service mailers have worked with us to develop Negotiated Service Agreements. Approval of a fourth NSA is pending with the Postal Rate Commission.

For consumers, we have filed an experimental rate case for Premium Forwarding Service, bringing a new level of convenience for customers who temporarily relocate. For a flat fee, all mail – including that not normally forwarded – is bundled and sent by Priority Mail to the customer's temporary address.

We have added flexibility to mail design and envelope preparation, providing mailers with creative opportunities to have their messages stand out with their customers. We have simplified package mailing by offering flat-rate and prepaid Priority Mail products. We have shared the results of research by the leading internet audience measurement service demonstrating that catalogs and direct mail can increase internet sales. We have established partnerships that place Postal Service shipping solutions on popular web sites. We have also taken advantage of advanced technologies to provide mailers with ready access to information about the status of their mail as it moves through our processing system.

In today's competitive environment, ease-of-use must be at the center of everything we do. This philosophy was behind the first comprehensive reorganization of our mailing standards in more than a decade, making it easier for customers to locate – and understand – the standards that apply to any type of mailing.

Similarly, we have consolidated our four field rates and classification service offices into a single Pricing and Classification Service Center. This expands the range of services offered to business mailers and enhances the timeliness, quality and consistency of decisions affecting mail classification. And, at the point of mailing, electronic systems are linking customer mailing information with Postal Service acceptance, verification and payment systems, streamlining business mail entry.

While our vast network of facilities has expanded over time to meet the needs of an ever-growing nation, we recognize that there are more cost-effective ways to bring the Post Office to our customer than constructing new buildings. The same technologies that provide today’s consumers with new ways to communicate also provide them with new ways to take advantage of our products and services.

Our website, usps.com, always a valuable source of mailing information, now offers quick, easy and convenient access to a broad range of products, services and features. Through usps.com, customers can buy stamps, pay postage, print mailing labels, select insurance, add delivery or signature confirmation, track delivery status, and arrange for carrier pickup of their prepaid packages.

We are bringing modern technology to our retail units as well. In the last year, we have installed more than 2,500 Automated Postal Centers in centrally located Post Offices throughout the nation. These popular, self-service kiosks, which offer 80 percent of retail services, make a visit to the Post Office quicker and more convenient because many are available around the clock, better meeting the needs of today’s busy consumer.

We will continue to encourage innovation in pursuit of revenue growth. This is every employee’s responsibility and it is a message we are communicating at every level and to every employee of the organization.

Of course, if we are to provide value to mailers, the products and services we offer must be supported by operational excellence and an intense focus on efficiency and cost management.

Over the last several years, we have extended the benefits of automation from letter mail to larger, flat-size pieces. And we are deploying a new Automated Package Processing System, which brings increased sorting efficiency, speed and accuracy to bundle and package handling. This will contribute to better service and reduced costs. Through advanced automation, we have also developed a more effective way to speed the delivery and reduce the expense of forwarding mail to customers who have moved.

Our Breakthrough Productivity Initiative, begun in 1999, continues to drive system standardization, improving efficiency and reducing costs. We recognize that in an organization the size of the Postal Service, no single group holds a monopoly on innovation. One of the greatest benefits of this initiative has been its success in identifying operational best practices, recognizing those who have developed them, and applying them broadly throughout processing plants and Post Offices from coast to coast.

We have also improved the efficiency and effectiveness of administrative systems and processes, from purchasing and accounting to information technology and human resources. We are serving our internal customers better, providing them with the information and services they need, and reducing costs as we do it.

At the heart of all of our efforts is our career workforce – the 700,000 men and women of the Postal Service. Some you know – your letter carrier, your postmaster, or the clerk at your local Post Office. Some you may not have met – our drivers, mechanics, custodians, supervisors, and the clerks and mailhandlers who keep our processing facilities operating around the clock.

We have been focused on improving their workplace environment, understanding that cooperative and collaborative working relationships will allow us to bring greater focus to meeting the needs of our customers. And the workplace is improving. Our unions have been instrumental in helping us find better ways to resolve workplace disputes and implement new programs to improve safety. Over the last three years, we have experienced a 61 percent reduction in grievances pending arbitration. Employees are safer, too, with a 36 percent decline in work-related illnesses and injuries.

We continue to make diversity a hallmark of our organization – and others are noticing. For the fourth straight year, Fortune magazine has named the Postal Service one of the "50 Best Companies for Minorities." A diverse workforce, by bringing us the experience and perspective that reflects the energy of the communities we serve, provides an important edge that supports our success. Our focus also includes efforts to recruit, develop and retain a diverse group of executives.

Our Human Capital initiatives place an emphasis on planning for the future. Leadership development is absolutely critical to the Postal Service as greater numbers of our supervisors, postmasters, managers, executives and officers near a time when they can consider retirement. A critical component of these efforts is our new Succession Planning process, an important tool in identifying and developing a pool of qualified candidates for executive positions. And our executives' responsibilities include working with staff to create individual development plans to help prepare them for positions of greater responsibility and realize their full leadership potential.

A significant innovation in our Human Capital activities is the Executive Development Program. We recognize that it is not enough simply to prepare our people to assume executive responsibilities. We must also support our executives with new managerial tools, fresh perspectives and shared experiences they might not normally encounter through their regular duties.

And, for our supervisory and managerial employees, we have introduced a new pay-for-performance system. Their compensation is now directly linked to the achievement of specific performance goals.

We are transforming the Postal Service. We are doing everything within our power to add value for our customers, improve operational efficiency, and enhance a performance-based culture.

How far have we come in three years? The results have been impressive.

Last year, through the outstanding efforts of our employees – and validated by independent measurement systems – we delivered record levels of service performance and customer satisfaction. For the second straight year, 95 percent of First-Class Mail for delivery to next-day service areas arrived on time. In fact, service in all measured categories is at record levels, contributing to a customer satisfaction rating of 94 percent.

Our success goes beyond service excellence. It includes a cumulative $8.8 billion reduction in costs since 2001. It includes a reduction of our debt by $9.5 billion, to $1.8 billion at the close of 2004. It includes a fifth straight year of positive total-factor productivity, the equivalent of $6.1 billion in cost savings. It includes bringing our staffing to pre-1985 levels, despite mail volume growth of 75 billion pieces and delivery point growth of 33 million addresses. It includes two consecutive years of positive net income, totaling $6.9 billion. And it includes the fact that, over the last 34 years the Postal Service has recovered all prior years' losses, meeting its statutory "break even" mandate. From 1972 through 2004, we have generated revenue of $1,246,200,000,000 sufficient to more than cover our costs of $1,245,300,000,000 during this period.

For our customers, one of the most significant – and visible – benefits of our transformation efforts has been steady rates. The price of postage has not changed since 2002 and will not change before 2006, a span of almost four years.

While the Postal Service has recently filed a rate case with the Postal Rate Commission, this is not a function of revenue failing to meet operational costs. We expect to end this year in the black, with positive net income exceeding $1 billion.

The Postal Service must seek a rate increase now to comply with the requirements of Public Law 108-18, the Postal Civil Service Retirement System Funding Reform Act of 2003. In adjusting our payments to help the Postal Service avoid overfunding this employee retirement program, the Act also requires that we pay $3.1 billion – the so-called "savings" between our former, higher payment rate and the current, lower rate – to an escrow fund beginning in 2006. This escalating escrow payment requirement will have a continuing and increasing effect on our finances, peaking at $7 billion in 2024.

In 2003, 2004 and 2005, the “savings” were used to help reduce debt, offset operational expenses and hold postage rates steady. If the escrow requirement did not exist, we could hold rates steady until 2007. Should legislation be enacted that eliminates the escrow funding requirement, this rate case will be withdrawn.

The future of America’s postal system, however, will depend on much more than the next rate case. It will depend on a series of critical actions and decisions – by the Postal Service, by the Congress and by the Administration.

As an organization, the Postal Service will stay focused on transformation. We will not step back from our pledge to ensure the continuation of affordable, universal service. We will not waver from our path of reducing costs and increasing efficiency to create value for our customers. To this end, last month at the National Postal Forum, we began gathering stakeholder input to assist us in updating the Transformation Plan to carry us through 2010.

Yet, we recognize that there will come a time when the efforts of the Postal Service alone will not be enough. Declining First-Class Mail volume, coupled with a market shift from higher-margin to lower-margin products, will result in insufficient revenue to support our infrastructure and the costs of an ever-expanding delivery network. We will reach a point when our ability to continue reducing costs reaches its limits. At that point, our options will be limited, and those options, by their very nature, will simply exacerbate the crisis.

One option is relying on rate increases to make up any financial shortfall. But, as electronic diversion continues to erode First-Class Mail volume, this product will become more price-sensitive than ever. Higher rates will likely increase the pace of change, accelerating the volume decline, resulting in falling revenue and the need, again, to increase rates. It is an economic model that is not sustainable in the long term and could lead to the proverbial death spiral that many have predicted.

A second option is to achieve continued savings by reducing basic service. This, too, would likely drive customers to embrace alternatives to the services we provide, contributing, again, to mail volume decline. At that point, we would face the same, inevitable revenue pressure that would create a fatal, upward price spiral.

As Comptroller General Walker told this Committee late in 2003, “since we placed the Service on our high-risk list in April 2001, the Service has developed its 2002 transformation plan, cut various costs, and improved its productivity. These are all positive, important steps which Postmaster General Potter ought to be commended for.” But he also cautioned that, “modest incremental steps cannot resolve the fundamental and systemic issues associated with the Postal Service's current business model.” Mr. Walker on that, and other occasions, has urged Congress to enact comprehensive postal reform legislation.

The President’s Commission on the U.S. Postal Service reached a virtually identical conclusion following its exhaustive study of the pressures faced by America’s postal system. As the Commission so succinctly put it, “Fundamental change is the only option that will deliver a high-quality, financially stable Postal Service.”

It is clear that we are closer to achieving comprehensive reform of the laws governing the Postal Service than at any time since today's self-sufficient Postal Service was created more than three decades ago.

The Postal Service is a system of amazing complexity. Its successful operation is based on the proper ration of finely-tuned interdependencies that allow it to meet its obligations to the nation. If a single element of that equation moves out of alignment, it can have a profound effect on the entire system.

We strongly believe that successful reform legislation will have to achieve the right balance in three basic areas: postal costs, postage rates, and service levels. If the Postal Service does not have the ability to control costs, postage rates will go up or service levels will fall. There are no other options. With that in mind, it is imperative that I reiterate a number of elements identified by the Governors of the Postal Service as essential to postal reform.

The escrow requirement established by Public Law 108-18 should be eliminated and the military service retirement payment obligation returned to the Department of the Treasury. In its place, we support the creation of a payment stream to prefund retiree health benefits. The Postal Accountability and Enhancement Act, S. 662, addresses both of these concerns. It creates a 40-year amortization payment schedule for these obligations. This level payment stream will be particularly important in a rate-cap environment. By returning this obligation to the Treasury, S. 662 creates a deposit in the retiree health benefit trust fund of $17 billion, which holds down the payments needed to amortize the retiree health benefits funding.

The portion of the costs of Civil Service Retirement System benefits for Postal Service employees attributable to their military service should not be borne by the Postal Service. The requirement that military service count toward a Postal Service employee's annuity is federal policy and a national obligation. In addition, the Postal Service is required by law to give preference to veterans when hiring new employees. While we support veterans' preference, shifting responsibility for military service from taxpayers to ratepayers is unfair. If this requirement is not removed, the Postal Service will be the only federal agency with employees covered by the Civil Service Retirement System that is required to fund these benefits.

We believe that reform legislation should incorporate changes in the area of labor, which accounts for almost 80 percent of our costs. Without any changes in labor and an unaltered escrow payment – and coupled with a declining volume and a growing delivery infrastructure – operation within a rate cap that reflects the Consumer Price Index becomes nearly impossible.

The Postal Service is a strong supporter of collective bargaining. It has helped to maintain a healthy balance between the needs of Postal Service customers and the needs of our employees. Current law requires the Postal Service and its unions to address wage issues through collective bargaining.

The same law also imposes major federal benefit programs for employees by statutory requirement – not through the collective-bargaining process. As a result, a significant portion – some 20 percent – of our total compensation costs are exempt from collective bargaining. This represents the largest category of costs over which we have no control. For this reason, we believe that comprehensive reform legislation should include the ability of the parties to fully negotiate employer-employee contributions to the Civil Service Retirement System, the Federal Employees Retirement System, the Thrift Savings Plan, and the Federal Employees' Health Benefits program.

As part of the collective-bargaining process, we remain committed to good-faith negotiations. Over the past several years, the Postal Service and its unions have been successful in negotiating agreements without the need for third-party arbitration.

Yet, based on our experience, and despite the best efforts of the Postal Service and our unions, we know there may be times when the parties may fail to achieve a negotiated agreement. When that occurs, the law requires mandatory arbitration. We believe that an arbitrator should be required by statute to factor into an award the economic history of the employer, its present financial health and ability to pay, as well as anticipated future growth, productivity, and total labor costs.

Reform bills introduced in this Congress propose expanding the role of a new regulatory body beyond that of the current Postal Rate Commission. We are strongly opposed to expanding that role to include the power to determine the range within which the Postal Service and its unions may negotiate wages. This could have a chilling effect on collective-bargaining and unnecessarily impede the parties' ability to achieve a negotiated agreement.

Besides flexibility in collective bargaining, we strongly believe we should be granted more rate flexibility and authority to introduce new postal services.

Today's ratemaking process is both costly and time consuming. General rate cases take at least 18 months to conclude and, by the time new rates are implemented, the market may have changed significantly. Consequently, we believe that the Postal Service should be granted the authority to change rates and introduce appropriate new postal services – both with Board approval and within a price range determined by the regulator – without prior approval.

As we have seen in recent years, our finances can be affected dramatically by developments outside our control, such as increases in fuel costs or an economic downturn. With more than 37,000 facilities and a fleet of more than 200,000 vehicles, this can add significantly to our costs.

Historically, postage rates have stayed within increases in the Consumer Price Index. Therefore, if the Postal Service had the authority to adjust rates within a predetermined range, we believe that the CPI could serve as an acceptable – though extremely challenging – price cap. Over 34 years, we have been able to keep postage rates within the Consumer Price Index. Our ability to do this in the future is severely challenged as we face declining volume and revenue and growth in delivery points. The issue of cost attribution becomes vital in a rate cap environment, as attributable cost becomes the floor for postage rates.

It is imperative that a reasonable exigency provision be included, particularly in a bill providing for a rate cap tied to the Consumer Price Index. Given the pressure of prefunding retiree health benefits, the funding of statutory benefits for current employees and other cost pressures, a "reasonable and necessary" standard is essential. H.R. 22, the Postal Accountability and Enhancement Act, pairs CPI with such an exigency.

It is extremely important that the current practice of cost causality be retained for attributing costs, rather than by economic theories which do not relate directly to the product and that obscure its true cost. We believe the cap should be applied at the aggregate level, and certainly no lower than each class of mail, to allow the Board to exercise the requisite pricing flexibility.

Any future changes in the scope of the postal monopoly should be considered within the context of the Postal Service's universal service mission and other social policy obligations. We believe that Congress, not the regulator, is best positioned to set national policy and strike the proper balance among these dimensions.

In some areas, we are requesting more authority. We recognize that with this expanded authority comes added responsibility, including oversight by Congress and the Administration. We believe this represents an appropriate response to protecting the public interest.

The primary emphasis of the Postal Service has always been service. That will not change. As stewards of this public trust, we recognize and accept the challenge of managing our national infrastructure of facilities and transportation in a cost-effective manner that does not sacrifice service. We also understand that we must continue to develop new products and services – as we enhance those already available – to meet the changing needs of our customers in a new century.

With a balanced approach, the Postal Service can continue to build on its accomplishments and serve the nation for many years to come. In achieving that balance in reform legislation, we must confront difficult and sensitive issues involving pricing, labor and service. We believe this is necessary if we are to achieve the ultimate, long-term benefits that can grow from reform.

We cannot lose sight of the big picture. We cannot address any one of these elements without the others. If we are to set rates – and operate successfully – within the limits of a price cap tied to the Consumer Price Index, we must have the means of managing costs that our outside of our control today – costs that continue their steady upward growth. In practice, we believe this can be accomplished through the ability to negotiate employee benefits. Without an appropriate check on cost inflation, a rate cap would place pressure on our ability to continue delivering outstanding service, affordably, to every home and business in America.

On behalf of the Postal Service, I commend this Committee for its work. The issue of postal legislative reform is complex. There has been no shortage of strongly held positions about the shape it should take. You have taken the time to listen to the many voices involved in this important conversation. You have taken the time to understand what is at stake.

We recognize that legislation of this magnitude must incorporate a wide range of interests and concerns. When all is said and done, however, the litmus test of postal management and the Board of Governors comes down to one, simple question, "Do the current reform bills make it more likely that we will be able to protect quality, universal mail service at affordable prices, for everyone in America?" As the Chairman of our Board, James C. Miller III explained to the mailing industry last month, "If not, we are better off with no bill at all."

We look forward to working cooperatively with you in pursuing an affirmative response to that critical question.

Thank you.

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