

Statement of Gary Grippo
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before the Committee on Homeland Security and Government Affairs
United States Senate
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I would like to thank Chairman Johnson and Ranking Member Peters for holding this important hearing and for inviting me to testify.

The USPS has been losing money for more than a decade and is on an unsustainable financial path. Moreover, the USPS is forecast to lose tens of billions of dollars over the next decade.

Task Force on the United States Postal System

With this in mind, on April 12, 2018, President Donald J. Trump created the Task Force on the United States Postal System. The Task Force is chaired by the Secretary of the Treasury and includes the Director of the Office of Management and Budget and the Director of the Office of Personnel Management. The Task Force was directed to evaluate the operations and finances of the United States Postal Service (USPS) and submit findings and recommendations to the President.

The Task Force conducted a robust analysis of the USPS's operations and finances, informed by an extensive review of information provided by the USPS, academic literature, and industry studies, as well as a review of legislative history, and meetings with members of Congress and the Congressional committees of jurisdiction.

In addition, the Task Force met with a wide range of stakeholders representing the USPS workforce, commercial, non-profit, and residential users of the USPS's services, and the USPS's suppliers and competitors. As directed by the Executive Order, the Task Force consulted with the Postmaster General, the Chairman of the Postal Regulatory Commission (PRC), the Attorney General on issues relating to government monopolies operating in the commercial marketplace, the Secretary of Labor on issues relating to workers' compensation programs, and state, local, and tribal officials. The Task Force also conducted a thorough review of quantitative data and research from public and private sources, including from the USPS, the U.S. Government Accountability Office (GAO), and the USPS Office of Inspector General (OIG).

In accordance with the Executive Order, the Task Force studied:

- i. The expansion and pricing of the package delivery market and the USPS's role in competitive markets;
- ii. The decline in mail volume and its implications for USPS self-financing and the USPS monopoly over letter delivery and mailboxes;
- iii. The USPS's "universal service obligation" in light of changes in technology, e-commerce, marketing practices, and customer needs;
- iv. The USPS's role in the U.S. economy and in rural areas, communities, and small towns; and
- v. The state of the USPS business model, workforce, operations, costs, and pricing.

The Task Force released a report on December 4, 2018. The report, *United States Postal System: A Sustainable Path Forward*, provides a series of recommendations to overhaul the USPS's

business model in order to return it to sustainability without shifting additional costs to taxpayers.

Scope of Work

The Task Force's review of the U.S. Postal System identified significant opportunities for reform that would enable the USPS to operate a sustainable business model and compete fairly in competitive markets. The Task Force considered both administrative and legislative reforms that take into account changes in the postal industry, the USPS's competitive advantages, and areas requiring improvement through either government or private sector-driven initiatives. The recommendations should be considered, in whole or in part, as the USPS and other stakeholders work to improve the USPS's business model and restore it to long-term sustainability.

A primary consideration for the Task Force was the USPS's importance to rural and remote locations within the United States, as both a service provider and employer in nearly every community in the country. The Task Force strongly believes that any potential postal reforms should not disadvantage those living in rural or remote locations.

Finally, as international mail and packages play a relatively small role in the overall economic performance of the USPS, representing 3.7 percent of total USPS revenue¹, the Task Force did not consider issues associated with the shipment and receipt of international mail and packages. However, the Task Force fully supports the August 23, 2018 Presidential Memorandum that instructed the Secretary of State to seek reforms to the Universal Postal Union (UPU) to achieve

¹ United States Postal Service, *Form 10-K for the Fiscal Year Ended September 30, 2018*, available at: <http://about.usps.com/who-we-are/financials/10k-reports/fy2018.pdf>

a system of fair and nondiscriminatory postal rates, and strongly supports the State Department’s October 17, 2018, notice of denunciation that begins the year-long process of United States withdrawal from the UPU. The Task Force is also pleased with the October 24, 2018 passage of the STOP Act, which will require the USPS to adopt advance electronic data for international mail shipments in order to help stop the flow of fentanyl, and other illegal shipments, into the United States through the USPS.

Unsustainable Financial Path

The USPS is a \$71 billion enterprise that collects, processes, transports, and delivers 146 billion pieces of mail and packages to nearly 159 million households and businesses annually.² The mission of the USPS is broadly defined through a “universal service obligation” (USO), which is intended to ensure that all citizens and businesses in the United States receive a minimum level of postal services at a reasonable price.

Over the last two hundred years, the USPS has provided “postal services to bind the Nation together through the ... correspondence of the people.”³ The nature of postal services in the United States has varied over time, but has trended towards higher levels of service.

In 2006, the Postal Accountability and Enhancement Act (PAEA) was signed into law and represented the first major postal reform legislation since 1970. The law’s passage followed the July 2003 release of the report of the President’s Commission on the United States Postal

² United States Postal Service, *Form 10-K for the Fiscal Year Ended September 30, 2018*, available at: <http://about.usps.com/who-we-are/financials/10k-reports/fy2018.pdf>

³ 39 U.S.C. § 101(a)

Service, which contained a set of recommendations for modernizing the USPS and improving service quality.⁴ Overall, the goal of PAEA was to begin managing the effects of an anticipated decline in mail volume due to the emergence of Internet communications. A key feature of the law was to place a cap on price increases for Market Dominant products to serve as a competition proxy to drive greater cost efficiency at the agency. Furthermore, the law required significant prefunding of retiree health care benefits.

The framing of PAEA was based on a projected levelling off and then a gradual decline in overall mail volume.⁵ The expectation led to a belief that the USPS would have time to restructure and build savings for its long-term liabilities before mail volume began to decline. Unfortunately, instead of a gradual decline in the years ahead, mail volume peaked in FY 2006 and began to decline immediately after the implementation of the law. Over the next decade, from FY 2007-17, overall mail volume declined by 28 percent (to 149.5 billion pieces) and total revenue from first-class and marketing mail declined by 27 percent (37 percent when adjusted for inflation).

While the law intended to prepare the USPS for the eventual decline in mail volume, it did not provide the flexibility needed to handle the unanticipated rapid decline. The impact of the shift toward digital correspondence and the corresponding decline in USPS mail volumes have been compounded by caps on mail pricing, put in place by PAEA, leading to mail revenue declines of around 4 percent per year. Additionally, the USPS has not been able to sufficiently reduce costs

⁴ “Embracing the Future: Making the Tough Choices to Preserve Universal Mail Service,” Report of the President’s Commission on the United States Postal Service, 31 July 2003.

⁵ “Embracing the Future: Making the Tough Choices to Preserve Universal Mail Service,” Report of the President’s Commission on the United States Postal Service, 31 July 2003.

to offset declines in revenue, leading to net losses totaling \$69 billion between FY 2007 and FY 2018. As a result, as of the end of FY 2018, the USPS balance sheet reflects \$89 billion in liabilities against \$27 billion in assets – a net deficiency of \$62 billion.⁶ For more information, see Appendix A.

Although package volumes are increasing due to the rise of e-commerce, package revenues alone cannot offset the decline in mail revenues. Additionally, as the USPS delivers more packages, it increasingly competes with private delivery companies and potentially distorts overall pricing in the package delivery market.

The USPS's business model – including its governance, product pricing, cost allocation, and labor practices – was sustainable in an era where mail revenues and volumes grew alongside population and economic growth. However, as the USPS's financial condition continues to deteriorate, standalone proposals, such as relieving the USPS of post-employment benefits liabilities, will be insufficient. The USPS's ability to achieve and maintain sustainability over the long-term is dependent upon formative reforms to its business model that will enable it to flexibly and swiftly adapt to the social, technological, and operational changes in the mail and package markets.

Recommendations of the Task Force

The Task Force's recommendations align with the following operating realities of the postal system:

⁶ “Embracing the Future: Making the Tough Choices to Preserve Universal Mail Service”, Report of the President's Commission on the United States Postal Service, 31 July 2003.

- The volume of First-Class and other mail is in decline;
- Initiatives must be taken to address both the USPS's revenues and costs; and
- Optimizing the unique franchise and monopoly value of the system is necessary.

The Task Force recommends that the USPS and Congress work to overhaul the USPS's business model in order to return it to sustainability. Both administrative and legislative actions are needed to ensure that the USPS does not face a liquidity crisis, which could disrupt mail services and require an emergency infusion of taxpayer dollars.

The Task Force believes that the reformed USPS business model must embody a new public policy goal, recognizing that private products and competitive markets increasingly meet the country's communications and commerce needs. The new policy goal should have the more targeted function of correcting the failures and inefficiencies of these private markets.

Central to this new model is the idea that the USPS's comprehensive delivery network that covers every address in the country is a critical part of the nation's infrastructure that cannot be replicated by private actors or displaced by emerging delivery technologies. The Task Force believes that maintaining this critical infrastructure, allowing for and continuing to deliver to every address in the United States, should be a primary business objective of the USPS.

The following provides a summary of the Task Force's recommendations. A full list of recommendations can be found in Appendix B.

Governance

The USPS suffers from a lack of institutional governance. The USPS's Governors are considered the "head of the agency" and are responsible for directing and controlling the USPS. Between December 2016 and August 2018, the USPS Board of Governors (the Board) had no Governors. In August 2018, the Senate confirmed two Governors – the first Governors confirmed by the Senate since 2010. Without Governors, the Postmaster General managed the USPS's financial and operational challenges without strategic direction and guidance, exacerbating management's limited power to effect needed organizational change. The Board should move to create a new policy mandate that resets the USPS's organizational direction and develops financial targets for the USPS. Governance should be strengthened with expanded Board controls and increased accountability. Moreover, if the USPS is unable to achieve a sustainable business model and satisfy its financial commitments, including those to other federal agencies, the PRC should be given stronger regulatory authority to take necessary revenue and expense measures.

Universal Service Obligation

The USO is a public policy that defines what citizens and businesses need from a government provided postal service, representing a mission statement for a country's postal system. The generally accepted attributes for defining the USO include specifying the geographic coverage for postal delivery, frequency of delivery, processing standards, mode of delivery, range of required postal products, level of access to post offices, and rules for affordable postal rates. For the USPS to achieve a sustainable business model, a new pricing structure needs to be established. The Task Force believes that a distinction must be made between the types of mail

and packages for which a strong social or macroeconomic rationale exists for government protection in the form of price caps, subsidies and mandated delivery standards (“essential services”), versus those types of mail and packages that are commercial in nature, and therefore would not have a basis for government protection. This distinction will provide the USPS and the PRC with a framework to sustainably manage pricing, costs, and products.

Pricing

With the rise of digital alternatives and the corresponding decline in mail volumes, across-the-board rate caps on mail products have become an obstacle to the USPS’s financial sustainability. Although the USPS does have pricing flexibility within its package delivery segment, packages have not been priced with profitability in mind. The USPS should have greater flexibility to establish rates for mail items that are not deemed “essential services.” This approach will allow the USPS to optimize its income in order to fund its operations, capital expenditures, and long-term liabilities.

Cost Allocation

The USPS’s current cost allocation methodology is outdated, leading to distortions in investment and product pricing decisions. The USPS’s current cost methodology does not take into account that market dominant and competitive products operate under different regulatory and market rules, nor does it capture the cost implications that the rapid decline in mail volume and the rapid rise of package volume have had on the USPS’s cost structure. Modernizing the USPS’s cost standards and allocation methodology is a key principle needed to reform the USPS. This

modernization will provide the USPS the information it needs to inform critical management decisions, government policies, and regulatory reporting.

Operating Costs

In order to move towards sustainability, the USPS must also address its rising labor and operating costs, including capital expenditures. The USPS's operating costs are expected to continue to grow as the country's population expands, new delivery points are added, and as the requirements for package delivery increase. The USPS must pursue new cost-cutting strategies that will enable it to meet the changing realities of its business model. These strategies should include evaluating modifications to delivery processing standards, and the expanded use of private sector partners in areas such as processing and sortation.

Labor Model

In FY 2018, labor costs accounted for 76 percent of the USPS's overall operating costs.⁷ Consistent with the President's Management Agenda to modernize the government workforce, the Task Force recommends that the USPS more closely align wages for both its career and non-career workers with the broader labor market.

Retiree Health Benefits

Congress requires the USPS to fund the retiree health benefits of its employees as part of a mandate for postal self-sustainability. The Task Force does not believe that this general policy should change or that the liability for USPS retiree health benefits should be shifted to the

⁷ United States Postal Service, *Form 10-K for the Fiscal Year Ended September 30, 2018*, available at: <http://about.usps.com/who-we-are/financials/10k-reports/fy2018.pdf>

taxpayers. The Task Force believes that this obligation, including the \$43 billion in pre-funding payments that the USPS failed to pay into the Postal Service Retiree Health Benefits Fund and the unfunded actuarial liability for retiree health benefits, must be restructured with the payments re-amortized with a new actuarial calculation based on the population of employees at or near retirement age.⁸

New Revenue Streams

The USPS should explore new business opportunities that will allow it to extract value from its existing assets and business lines. For example, the USPS should explore licensing access to the mailbox. The USPS could also capture additional value from its existing retail offices by converting post offices into contract post offices or by co-locating with or renting space to complementary retail establishments. However, given the USPS's narrow expertise and capital limitations, USPS should not pursue expanding into new business sectors, such as banking, where the USPS does not have a demonstrated competency or comparative advantage, or where balance sheet risk would be added.

Conclusion

The USPS is on an unsustainable financial path and is forecast to lose tens of billions of dollars over the next decade. Action is needed in order to return the USPS to financial health. The recommendations of the Task Force promote commerce and communications throughout the United States, without shifting additional costs to the taxpayer. The Task Force looks forward to

⁸ United States Postal Service, *Form 10-K for the Fiscal Year Ended September 30, 2018*, available at: <http://about.usps.com/who-we-are/financials/10k-reports/fy2018.pdf>

working with the USPS, its Board of Governors, the PRC, and Congress to help implement the recommendations outlined in the report.

Appendix A: USPS Revenue, Expenditures, and Volume Trends

| USPS Domestic Mail and Package Revenue and Volume Trends (in Billions) | | | | | | | | | |
|--|-------|-------|--------|-------|-------|-------|-------|-------|-------|
| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
| Mail Revenue (\$) | 50.6 | 49.0 | 47.0 | 46.7 | 47.4 | 47.5 | 46.6 | 43.6 | 42.7 |
| Mail Volume (pieces) | 166.9 | 164.1 | 155.4 | 153.7 | 150.5 | 148.7 | 148.2 | 142.7 | 139.9 |
| Package Revenue (\$) | 10.3 | 10.7 | 11.6 | 12.6 | 13.8 | 15.1 | 17.5 | 19.5 | 21.5 |
| Package Volume (pieces) | 3.1 | 3.3 | 3.5 | 3.7 | 4.0 | 4.5 | 5.2 | 5.7 | 6.2 |
| USPS Revenue and Expenditures (Dollars in Billions) | | | | | | | | | |
| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
| Total Revenue | 67.1 | 65.7 | 65.2 | 67.3 | 67.9 | 69.0 | 71.5 | 69.7 | 70.7 |
| Expenses Excluding RHB | 70.1 | 70.8 | 70.1 | 66.7 | 67.7 | 68.3 | 71.3 | 68.2 | 70.0 |
| Operating Income (prior to RHB) | (3.0) | (5.1) | (4.8) | 0.6 | 0.2 | 0.6 | 0.2 | 1.5 | 0.7 |
| RHB (10-Year Prefunding) | 5.5 | 0.0* | 11.1* | 5.6 | 5.7 | 5.7 | 5.8 | - | - |
| RHB (40-Year Amortized Prefunding) | - | - | - | - | - | - | - | 1.0 | 0.8 |
| Annual Accrual of RHB | - | - | - | - | - | - | - | 3.3 | 3.7 |
| Net Income (Including RHB) | (8.5) | (5.1) | (15.9) | (5.0) | (5.5) | (5.1) | (5.6) | (2.8) | (3.9) |

* The USPS failed to prefund its retiree health benefit (RHB) payments after 2010. Congress shifted the USPS's 2011 prefunding payment to 2012, resulting in an \$11.1 billion liability in 2012.

Source: USPS 10-K Filings, 2007-2018

Appendix B: Task Force Recommendations

| Recommendation | Policy Action |
|--|----------------|
| <i>Universal Service Obligation (USO)</i> | |
| <i>Definition</i> | |
| Clearly define the USO. Provide a targeted definition of minimum, essential postal services, that due to specific social and economic needs have a basis for government protection. | Administrative |
| <i>Geographic Scope</i> | |
| Keep current practice, which designates that the USO includes all addresses in the country covering “the United States, its territories and possessions,” ⁹ irrespective of population density. | Administrative |
| <i>Number and Density of Post Offices and Collection Boxes</i> | |
| Establish a rule that specifies that access to the postal system must only be sufficient to implement defined USO standards for delivery. | Administrative |
| <i>Delivery Frequency</i> | |
| Provide greater flexibility to determine mail and package delivery frequency. | Legislative |
| <i>Mode of Delivery</i> | |
| Maintain current discretion to determine mode of delivery consistent with a financially sustainable business model. | Administrative |
| <i>Processing Standards</i> | |
| Keep current practices, which allow the USPS to manage processing standards. | Administrative |
| <i>USO Funding</i> | |
| Review and determine if income generated by activities defined to be outside of the USO could be optimized to cover the costs of funding the USO. | Administrative |

⁹ 39 U.S.C. § 403. Section 403(a) provides that the USPS “shall serve as nearly as practicable the entire population of the United States.”

| Recommendation | Policy Action |
|---|----------------|
| <i>Mail and Package Markets</i> | |
| <i>Business Model</i> | |
| Develop a new model that can be used to both set rates and control costs to achieve sustainability. | Administrative |
| Require price increases, reduce service costs, or exit the business for any mail products that are not deemed an essential service and do not cover their direct costs. | Administrative |
| <i>Product Classes</i> | |
| Product Classes: Redefine mail classes by creating products defined by the type of sender and the declared purpose of the mail item. | Administrative |
| Tracking Data: Change USPS systems in order to track the purposes and uses of mail, to allow for better cost allocation, targeted pricing, and more business intelligence. | Administrative |
| <i>Strategic Options</i> | |
| Evaluate areas of USPS operations where the USPS could expand third party relationships in order to provide services in a more cost efficient manner (e.g., mid-stream logistics and processing). | Administrative |
| As a means of generating more income, the mailbox monopoly could be monetized. | Administrative |
| Price competitive products in a manner that maximizes revenues and generates income that can be used to fund capital expenditures and long-term liabilities. | Administrative |
| <i>Costing Options</i> | |
| Develop a new cost allocation model to establish full price transparency and fully distribute costs. | Administrative |
| Establish a separate balance sheet for packages to help prevent cross-subsidization between the mail and package business units. | Administrative |

| Recommendation | Policy Action |
|--|---------------|
| <i>Operating Model</i> | |
| <i>Operations</i> | |
| Align USPS employee rights with other federal employee rights by eliminating collective bargaining over compensation for USPS employees. | Legislative |
| Pursue reforms to USPS employee wages consistent with those proposed for the broader federal workforce in the President’s Management Agenda. | Legislative |
| Explore and implement new business lines that generate revenue, and that present no balance sheet risk to the USPS. | Legislative |
| <i>Governance and Oversight</i> | |
| Strengthen the governance and regulatory oversight of USPS. This could be achieved through reforming, but maintaining, the existing institutional structures or by changing the institutional structures, which would require legislation. | Legislative |
| Institute a new policy mandate for management that sets organizational direction and financial targets, which align with a sustainable business model and establish an enforcement mechanism if the existing Board is unable to meet these targets. | Legislative |
| Strengthen the regulatory oversight role of the PRC, providing the PRC with expanded controls, imposing increased accountability on the USPS. | Legislative |
| <i>Benefits</i> | |
| Pursue reforms proposed to the Federal Employees’ Compensation Act that are included in the President’s FY 2019 Budget. | Legislative |
| Pursue reform of the Federal Employee Retirement System that would increase employee contributions and move toward a defined contribution system. | Legislative |
| Maintain but restructure the retiree health benefits liability, including the \$43 billion in pre-funding payments that the USPS failed to pay into the Postal Service Retiree Health Benefits Fund and the unfunded actuarial liability, with the total liability re-amortized with a new actuarial calculation based on the population of employees at or near retirement age. | Legislative |