

Testimony of
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I. Introduction

Thank you Chairman Johnson and Ranking Member Carper for the opportunity to participate in today’s hearing. I am a letter carrier from Sarasota, Florida and have served as the President of the National Association of Letter Carriers (NALC) since 2009. NALC represents nearly 200,000 active Letter Carriers who work for the Postal Service across the United States. With more than 90% voluntary membership, our union is among the best organized open-shop unions in America. We also represent nearly 90,000 retired letter carriers who maintain their membership in NALC.

You have asked me to focus my testimony today on the impact of legislative and regulatory burdens placed on the USPS, including the mandate to prefund the Retiree Health Benefits Fund. Given that the mandate to prefund, which no other public or private enterprise faces, accounts for more than 86% of the Postal Service’s reported losses in recent years – that is an appropriate place to focus.

However, in today's testimony, I will also address two other very significant burdens that prevent the Postal Service from setting its prices and investing its retirement trust funds sensibly and appropriately. And at the end of my testimony, I will speak in support of a set of reform measures that all four postal employee unions endorse along with a broad industry coalition, which includes the Postal Service and dozens of major companies and business mailers.

Before I address the legislative and regulatory burdens, I would like to briefly share our views on the over-arching theme of this hearing – the “reality of the Postal Service.” This is important because that reality has changed dramatically – for the better – in recent years. It is not 2008-2009 anymore when the Great Recession and the mandate to pre-fund the retiree health fund sent mail volume plummeting, crushed the Postal Service's finances, and raised doubts in the minds of some about the long-term viability of the Postal Service. It led some doubters to propose radical service cuts and a general dismantling of one of America's oldest and most beloved institutions.

Although America's letter carriers and other postal employees never shared those doubts and urged Congress to resist counter-productive service cuts, we worked with the Postal Service to reorganize and adapt to changing postal needs of the country, both the decline in letter mail due to technological change and the boom in e-commerce that reflects the two sides of the internet coin. Over the past nine years, postal employees have made huge sacrifices to help the Postal Service to become more efficient and to “right-size” in response to the fall in mail volume. Postal employment has been slashed by more than 200,000 jobs since 2006. Meanwhile, postal productivity has increased dramatically and postal labor costs have been sharply reduced through very difficult rounds of collective bargaining.

Thanks to these efforts and to the recovery from the Great Recession, the Postal Service has been returned to operational profitability in recent years. The USPS earned operating profits of \$1.4 billion in FY 2014 and \$1.2 billion in FY 2015. Of course, these operating profits were totally wiped out by the \$5.7 billion annual prefunding charges in the Postal Service's official results. But that should not obscure the underlying strengths of the Postal Service. As the economy has recovered, it has seen its package business grow by more than 10 percent annually and both its direct mail and catalogue products grow solidly even as the rate of decline in First Class Mail volume steadily moderated (from -8.8% in 2009 to -2.2% in 2015). Overall, mail volume declined by less than one percent in 2015 as total revenue increased by 1.6 percent to \$68.9 billion.

Indeed, the Postal Service remains a vital component of this country's economic and communications infrastructure. In 2015, the Service delivered more than 150 billion pieces of mail and became an even bigger player in the booming e-commerce sector, now offering seven-day delivery. According to the Postal Service's annual study of mailing trends, a large majority of bills and statements received by households are still delivered by mail, and more than a third of them are still paid through the mail. Trillions of dollars move through the postal system every year. The Postal Service's \$69 billion in revenue is only a small part of the \$1.4 trillion of Gross Domestic Product accounted for by the U.S. mailing industry, which now employs 7.5 million Americans. The vitality of that huge industry depends on a healthy Postal Service.

So this is the reality we face: Although its finances remain fragile and technological challenges will persist long into the future, it should be clear that the Postal Service remains a vital part of the nation's infrastructure. We believe it can thrive in the 21st Century with the right public policies. We have done our part to preserve the Service, which enjoys an 83 percent

approval rating with the American people according to a November Pew Research survey. Now we need Congress to do its part to strengthen it for the future.

II. Legislative and Regulatory Burdens

As I suggested above, there are three significant legislative/regulatory burdens placed on the Postal Service under current law that should be removed or reformed by this Congress.

The prefunding mandate

The most significant burden is the legislative mandate included in the Postal Accountability and Enhancement Act of 2006 (PAEA) that requires the Postal Service to massively prefund future retiree health premiums -- decades in advance. As the Chairman has noted, this turned a long term liability into a very expensive short-term liability. Congress adopted this mandate during the administration of George W. Bush in the most inflexible manner possible. It required the Postal Service to make 10 fixed payments of between \$5.4 billion and \$5.8 billion annually between 2007 and 2016 – and then to begin making actuarial-based pre-funding payments over 40 years, beginning in 2017. The actuarial-based payments are comprised of two parts: a normal cost payment to cover the future cost of retiree health accrued each fiscal year, and a payment calculated to amortize any remaining unfunded liability over the next 40 years.

Unfortunately, in the absence of legislative change, the cost of pre-funding is actually expected to increase after 2016 as a result of these actuarial-based payments – beyond the unaffordable levels of recent years.

No other enterprise in America (public or private) faces a legal mandate to prefund future retiree health insurance benefits – though Congress does appropriate money to the Department of Defense (DOD) to partially pre-fund such benefits for DOD-related retirees. According to an annual survey of Fortune 1000 companies by Towers Watson, only 38 percent of such firms pre-fund retiree health at all, and 62 percent don't prefund at any level. (See Perspectives:

Accounting for Pensions and Other Post-Retirement Benefits, 2015.) Those companies that voluntarily pre-fund typically make contributions only when they are profitable.

The Postal Service pre-funding payments, which could not be suspended when the Great Recession hit, were so onerous that the Postal Service exhausted its \$15 billion borrowing authority in order to make the payments. Since 2012, it has not been able to make the payments at all – though the expenses associated with the missed payments have continued to be recognized, driving the Postal Service deep into the red. All told, \$49 billion of the Postal Service's reported losses of \$56.8 billion since 2007 – 86.3 percent -- are due to the pre-funding mandate. See Attachment #1.

The damage this policy has inflicted goes far beyond the adverse financial effects. This policy has starved the Postal Service of needed investments, most notably the urgent need to replace its obsolete fleet of vehicles. The USPS now wastes hundreds of millions of dollars annually to maintain outdated vehicles and has great difficulty finding replacement parts. The policy has also caused the Postal Service to excessively down-size in ways that are short-sighted and counter-productive. For example, the Postal Service made it more difficult for Americans to access its services by: removing tens of thousands of mail collection boxes; slashing the operating hours of thousands of post offices; and reducing its service standards in order to dramatically downsize its network of mail processing plants. The quality of service has suffered – and we fear the Postal Service has driven significant business away as a result.

Over the years, we have suggested a number of legislative measures to address the crisis caused by the pre-funding mandate – for example, repealing the mandate, reducing the pre-funding target percentage to match private sector best practice (33%-50% prefunding) or adopting private sector pension valuation standards so that USPS pension surpluses could be

transferred into the Retiree Health Fund. Those proposals failed to advance. Fortunately, this Committee reached bipartisan consensus on a concept to address the prefunding burden during the last Congress in S. 1486. Reforms to the Federal Employees Health Benefit Program (FEHBP) as it relates to postal employees and Medicare coverage would all but eliminate the unfunded liability for future retiree health. Maximizing enrollment in Medicare Parts A and B and giving FEHBP plans covering eligible postal retirees access to low-cost prescription drugs made available by the Medicare Part D law would increase total Medicare spending by less than two-tenths of one percent and virtually eliminate the Postal Service's unfunded liability – something no other public or private sector company has achieved. We urge this Committee to embrace this approach again this year. I will return to this idea in the final section of my testimony.

Restrictive investment policies for postal retirement funds

In general, the Postal Service has incredibly well funded retirement plans, although declining interest rates in recent years have inflated liabilities and created unfunded liabilities. At the end of 2014, the Postal Service's pension accounts (within the Civil Service Retirement System and the Federal Employees' retirement System) were 92.4 percent funded – well into the healthy “green zone” under the private sector Pension Protection Act, and much better than the 81.7 percent funded percentage for the 100 largest pension plans according to the 2015 Pension Funding Survey conducted by the Milliman Company. (The USPS funded percentage at the end of FY 2015 was 92.2 percent.) At the same time, while the median level of funding for retiree health benefits among Fortune 1000 companies is zero percent (0%), the Postal Retiree Health Benefit Fund is nearly 50 percent funded.

These strong funding positions are all the more remarkable given the restrictions placed on the investment of the Civil Service Retirement and Disability Fund (which holds the federal and postal accounts for both CSRS and FERS) and the Postal Service Retiree Health Benefits Fund

(PSRHBF). By law, the pension funds and the PSRHBF must be invested in low-yielding Treasury bonds. Together, the CSRS and FERS postal accounts and the PSRHBF hold nearly \$340 billion in Treasury securities – making us, the Postal Service and its employees, the third largest creditor of the U.S. federal government just behind the governments of China and Japan. No private company in America would invest 100 percent of their pension and post-retirement health funds in such a conservative way, especially during a period when Treasuries are yielding 2-4% returns. When your investment time horizon stretches out over decades, best practice in the private sector is to invest in a well-diversified portfolio of private sector stocks, corporate bonds and real estate, as well as government bonds. Such a portfolio is provided by the Thrift Savings Plan's (TSP) Lifecycle 2040 Fund. If the Postal Service's FERS and CSRS accounts could have been invested the 2040 Fund between 2007 and 2014, their combined balance would be \$32 billion greater today – enough to cover the total combined unfunded liability of \$23 billion in 2014. Had the PSRHBF been invested in the TSP's 2040 Fund, it would have doubled its annual returns.

Given that the postal accounts in CSRS and FERS are commingled pensions, covering both federal and postal employees, it might be difficult to invest the postal accounts more sensibly. However, Congress should direct the Office of Personnel Management (OPM) to invest the Postal Service Retiree Health Benefits Fund the way a private sector company would invest such a fund – again, in a well-diversified portfolio of private sector stocks and bonds as well as government securities.

Although, such a mandate would represent a break with past policy, the retiree health fund is a stand-alone, one-agency trust fund in the U.S. government's accounts. Its assets are funded by postage rate-payers to cover the cost of future retiree health insurance premiums payable by the Postal Service. The cost of these premiums, like medical services in general, is

expected to rise by 5.0-7.0 percent annually over the next several decades. It makes no financial sense to invest in assets that yield less than the trend rate of medical inflation. The PSRHBF investment policy in current law – which effectively mandates a low-cost loan from business mailers to the Federal government -- unnecessarily raises the cost of pre-funding and puts pressure on the Postal Service to raise postage rates or to cut services. There is a better way.

Congress could raise the long-term rate of return on the retiree health fund's assets, improve the overall finances of the federal government (OPM's balance sheet), reduce the burden of prefunding, relieve upward pressure on postage rates, and lessen the misguided impulse to cut services by changing the PSRHBF's investment policy. It could direct the OPM to invest PSRHBF assets in safe, low-cost index funds of the kind offered by the federal TSP. Alternatively, it might authorize the OPM to invest the Retiree Health Fund the same way the Tennessee Valley Authority (TVA), Amtrak and the Pension Benefit Guarantee Corporation (PBGC) invest the pension assets they hold.

There are two common objections to this investment proposal: (1) is the risk of loss associated with investments in private stocks and bonds; and (2) is the long-standing policy of the Treasury department against investing government trust funds (such as the Social Security Trust Fund) in private securities. Neither of these objections should hold in the case of the PSRHBF. I will address both.

First, given the long investment horizon of the PSRHBF and the relatively modest annual outlays from the fund (\$3.0-\$4.0 billion for the foreseeable future), the risk of a short-fall in a prudently invested PSRHBF is extremely small. In fact, the OPM projects future retiree health liabilities over a period of 90 years. So the Fund would have decades to make up for any sharp

losses. Indeed, the experience of the L 2040 Fund since the 2008 financial crisis provides a real life test of this resiliency. The L 2040 Fund has more than bounced back from the 2008 stock market crash.

Second, although the Treasury has traditionally invested government trust funds only in government bonds, the PSRHBF is a different kind of trust fund and there are several government entities that regularly invest in private securities.

The PSRHBF is different from most trust funds because it does not involve federal taxpayer dollars. The funds in the PSRHBF come from postage rate-payers. They are collected to cover the cost of services rendered. As with the assets of the TSP's index funds, the PSRHBF is dedicated to providing post-retirement benefits for federal employees – in this case, the employees of the Postal Service. Although it is the only trust fund dedicated to cover the retiree health benefits of a single agency's employees, there are other retirement funds controlled by primarily self-funded federal agencies that are allowed to invest in private sector securities. These include: the National Railroad Retirement Investment Trust (NRRIT), the PBGC, Amtrak and the TVA.

The ratepayer funds held by the postal retiree health fund should be invested the way these other agencies invest their funds. The OPM should hire well-qualified asset managers, chosen by trustees with fiduciary responsibilities to invest the fund wisely – maximizing returns while minimizing risk and investment fees.

To show you how beneficial this change in investment policy could be, last year we asked consultants at the Lazard Co. in New York to calculate what the funding balance of the

PSRHBF would be if the Fund been invested the way well-diversified public pension plans were between 2007 and 2014. Lazard's analysis found that the Retiree Health Fund's assets would have been between \$3.5 billion and \$9.7 billion greater if the Fund had followed the investment policies employed by organizations such as the PBGC, CALPERS or the National Railroad Retirement Investment Trust. See attachment #2.

While no pension fund achieves its long-term target rate of return every year and sometimes even loses money in market downturns, the Lazard analysis shows that the PSRHBF could be fully funded over the long run. If enacted in conjunction with the FEHBP/Medicare reforms proposed by S. 1486 and the iPost legislation, such an investment policy would more than fully fund future retiree health benefits. These policies would eliminate the need for any amortization payments and could justify the suspension of normal cost payments as well. Indeed, we do not believe the Postal Service should be required to maintain a funding balance of more than 100 percent over time and, if this investment proposal were adopted, we would urge the Senate to draft the law accordingly.

Properly investing the PSRHBF's assets will, over the long run, improve the balance sheet of the OPM and reduce the cost of pre-funding for the Postal Service. This will allow for affordable postage rates and better service to the America's mailers and citizens. If the purpose of the Fund is to protect taxpayers against the need to cover future health care costs for retired postal employees, the best way to reduce that need is invest the PSRHBF prudently and intelligently. In our view, investing the PSRHBF in low-yielding Treasury securities actually increases the risk of a taxpayer bailout in the future. Investing it in private sector securities would reduce that risk.

Pricing restrictions

The final legislative/regulatory burden we would like to address is the overly restrictive Consumer Price Index (CPI)-based price cap introduced by the PAEA to regulate postage rates charged for Market Dominant products (most letters, magazines and catalogues). One of the main goals of the PAEA was to simplify the rate-setting process, making it faster and less costly. A Senate bill passed in 2006 proposed to index all postage rates to inflation (CPI-All Items) and to allow for emergency rate increases in so-called "exigent" circumstances -- such as gas price spikes or severe recessions. The bill advanced in the House of Representatives called on experts at the PRC to create a new system of rate regulation based on best practice among regulators of other regulated industries, after conducting hearings to gather input from all the interested parties. As often happens in Congress, a little bit of both approaches was adopted in the PAEA – which called for the CPI index for 10 years and then authorizing the PRC to decide how to structure the rate-setting process after that. That is exactly what the PRC will do, beginning in December 2016.

The PAEA might have worked better but for two factors. First, the Postal Service decided not to exercise its option to hold one last old-fashioned rate case in 2007 to ensure rates covered all the relevant costs (including the massive cost of prefunding retiree health) before the new CPI price index was initiated. Facing a possible recession in 2007, the USPS did not want to raise postage rates by the extra 5% needed to build the cost of prefunding into the baseline rates before the index kicked in. It feared a rate shock would be especially damaging in the middle of a recession. That turned out to be a huge mistake--it should have done the rate case, and asked the PRC to delay implementing the results until after the recession.

Then the second factor kicked in: the economic slowdown of 2007 turned into a global financial crisis. The operating profits of 2007 and 2008 turned into deep losses of 2009-2012 as

the Great Recession took hold, mail volume plummeted and the \$5.5 billion annual prefunding payments kicked in. In response to the recession, the Postal Service sought and received a 4.3 percent exigent rate increase from the PRC. But USPS failed to convince regulators to make the increase permanent -- even though it was apparent to all that the Great Recession had permanently reduced the volume of First Class Mail as companies shifted to electronic billing to cut costs during the downturn. As it now stands, the 4.3 percent exigent increase will expire in March or April (unless the Congress acts to make it permanent beforehand). Such a rate decrease is likely to be short-lived – it would increase the chance of a major rate shock following the PRC review in 2017. We believe severe rate fluctuations would undermine the health of the Postal Service.

As this committee thinks about this issue, it should remember that the overall Consumer Price Index (All items) has no real meaning as it relates to the costs of the postal industry. It is simply the average change in prices for thousands of different goods and services bought by American consumers – it is a statistical artifact.

In 2006, we argued that a more appropriate index was the Consumer Price Index for Delivery Services (CPI-DS) – a sub-index within the CPI-All Items index that measures price trends for services provided by private delivery companies. That is, the prices charged consumers by companies like FedEx and UPS. As an indexing benchmark, the CPI-DS makes sense as it would hold the Postal Service to a rational private sector standard. And it captures the kinds of costs that affect delivery and postage prices – the cost of labor in our industry, the price of fuel, and inflation trends in a transportation/utility company. Another reasonable option would be the Producer Price Index for Delivery and Warehouse Industries. As you will note by reviewing Attachment #3 these more comparable indices have increased significantly more than the CPI since the PAEA was passed.

We believe that the PRC is the appropriate venue for deciding the future regulation of postage rates. In the meantime, we hope Congress will soon pass a bill that will make the exigent increase permanent and virtually eliminate the cost of prefunding in the coming months. But if it doesn't pass legislation, the 2016-17 PRC review of the rate-setting process will have to address both the burden of prefunding and the need to make the exigent increase permanent. That could lead to terrible rate shock that neither Congress nor the Postal Service's diverse group of stakeholders would welcome.

III. Key components to consensus legislation

Finally, I wish to urge this Committee to take immediate and urgent action to adopt legislation to stabilize the Postal Service. There is a remarkable degree of consensus across a broad range of stakeholders – including the unions, postal management and a representative sample of mailing industry companies – about the most important reform elements, which are outlined in Attachment #4. In short, we support:

- The use of postal-specific assumptions in valuations of the Postal Service's pension plans with any surpluses returned to the Postal Service over time;
- Reform of the Federal Employees Health Benefits Program as it relates to coverage of postal employees and postal annuitants to dramatically reduce the cost of retiree health benefits by integrating with Medicare (to which the Postal Service and its employees have paid \$29 billion in payroll taxes), and direct the PSRHBFB to be invested in index funds comprised of private sector stocks and bonds as well as government bonds;

- A freeze on postage rates until January 2018 while keeping the 4.3% exigent rate increase in effect until then (instead of letting it expire); and
- Allowing the Postal Service to deliver beer, wine and spirits and to provide non-postal products in limited circumstances.

The common characteristic of our elements or principles for reform is that they adopt standard practices used by large companies in the private sector. Most are drawn from ideas included in S. 1486 and maintained in Senator Carper's I-Post proposal. Senator Carper and former Senator Tom Coburn, with Senator Johnson's support, deserve much credit for their determined and patient work in helping to build this consensus.

Of course, our coalition could not agree on every issue – many of us support provisions about which there is not total consensus, and we know individual senators and groups of senators will want to address other issues. As a group, our coalition has agreed to work diligently to engage with this Committee on these issues as they arise and to work in good faith to reach a fair resolution. The four unions pledge to work as long as it takes to make this happen.

Thank you, Chairman Johnson, Ranking Member Carper and all the Members of the Committee for inviting me to testify on this crucially important matter.