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U.S. POSTAL SERVICE

Financial Crisis Demands Aggressive Action

Statement of Phillip Herr, Director
Physical Infrastructure Issues

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GAO-10-538T

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Highlights

Highlights of GAO-10-538T, a testimony to the Subcommittee on Financial Services and General Government, Committee on Appropriations, U.S. Senate

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U.S. POSTAL SERVICE

Financial Crisis Demands Aggressive Action

Why GAO Did This Study

The U.S. Postal Service's (USPS) financial condition and outlook deteriorated significantly during fiscal year 2009. USPS was not able to cut costs fast enough to offset declining mail volume and revenues resulting from the economic recession and changes in the use of mail, such as electronic bill payment.

In July 2009, GAO added USPS's financial condition and outlook to its High-Risk List and reported that USPS urgently needed to restructure to improve its financial viability. Declines in mail volume and revenue, large financial losses, increasing debt, and financial obligations will continue to challenge USPS.

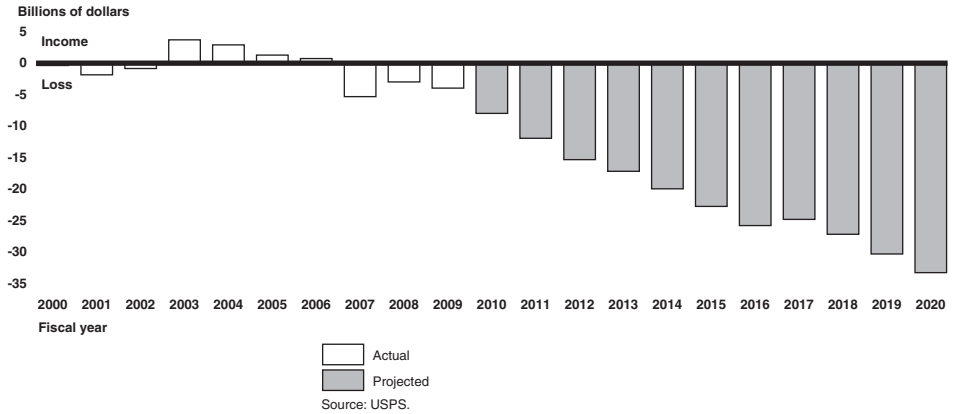
This testimony provides (1) information on USPS's financial condition and forecast and (2) GAO's perspective on the need for USPS restructuring. In addition, questions and issues are included for Congress to consider regarding USPS's proposal to reduce delivery from 6 to 5 days. This testimony is based on GAO's past and ongoing work, including its work on postal reform issues, its report adding USPS's financial condition and outlook to its High-Risk List, and updated information on USPS's financial condition and outlook.

View GAO-10-538T or key components.
For more information, contact Phillip Herr, at (202) 512-2834 or herrp@gao.gov.

What GAO Found

As mail volume declined by 35 billion pieces (about 17 percent) in fiscal years 2007 through 2009, USPS's financial viability deteriorated, with close to $12 billion in losses, and it does not expect total mail volume to return to its former level when the economy recovers. USPS forecasts that total mail volume will decline to 167 billion pieces in fiscal year 2010—the lowest level since fiscal year 1992, and 22 percent less than its fiscal year 2006 peak. It also projects a record loss of over $7 billion. Further, USPS has halted construction of most new facilities and expects to borrow $3 billion in fiscal year 2010, which would bring its total outstanding debt to $13.2 billion, close to its $15 billion statutory limit. Looking forward, USPS projects that by fiscal year 2020, total mail volume will further decline by 16 percent, to the lowest level since 1986. Absent additional actions to cut costs and increase revenues, USPS expects financial losses will escalate over the next decade.

USPS Actual and Projected Net Income (Loss), Fiscal Years 2000 to 2020



Source: USPS.

Action is urgently needed in multiple areas by USPS and Congress to address USPS's pressing challenges so that it can achieve financial viability, including restructuring USPS operations, networks, and workforce to reflect changes in mail volume, revenue, and use of mail. The longer it takes for USPS and Congress to address USPS's challenges, the more difficult they will be to overcome. When GAO placed USPS's financial condition and outlook on its High-Risk List, it identified the following key actions USPS and/or Congress could take: reduce employee compensation and benefits; consolidate retail and processing networks; consolidate administrative field structure; generate revenue through new or enhanced products; change funding requirements for retiree health benefits; and realign delivery services. GAO will analyze USPS's proposal to reduce delivery from 6 to 5 days when it becomes available. Included in this testimony are questions and issues for Congress to consider regarding delivery changes. GAO will also be issuing its report later this spring that provides its perspective on USPS's financial crisis, as well as additional options for restructuring.

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, a topic we have been continually monitoring given USPS's deteriorating financial condition during fiscal year 2009. My statement will provide (1) information on USPS's financial condition and forecast and (2) our perspective on the need for USPS restructuring. In addition, we provide questions and issues for Congress to consider regarding USPS's proposal to reduce delivery from 6 to 5 days.

My statement is based upon our past and ongoing work, including our work on postal reform issues, our report adding USPS's financial condition and outlook to our High-Risk List, and updated information on USPS's financial condition and outlook. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

USPS's Financial Condition Has Deteriorated and its Outlook is Poor

As mail volume declined by 35 billion pieces (about 17 percent) in fiscal years 2007 through 2009, USPS's financial condition deteriorated, with close to $12 billion in losses, and it does not expect total mail volume to return to its former level when the economy recovers. This volume decline was largely due to the economic downturn and changing use of the mail, with mail continuing to shift to electronic communications and payments. In July 2009, we added USPS's financial condition and outlook to our High-Risk List and reported that USPS urgently needed to restructure to address its financial viability.[1] Despite $6.1 billion in cost savings in fiscal year 2009 as well as congressional action that relieved USPS of $4 billion in mandated payments to prefund postal retiree health benefits,[2] USPS still reported a loss of $3.8 billion for the year. Also, USPS debt increased by

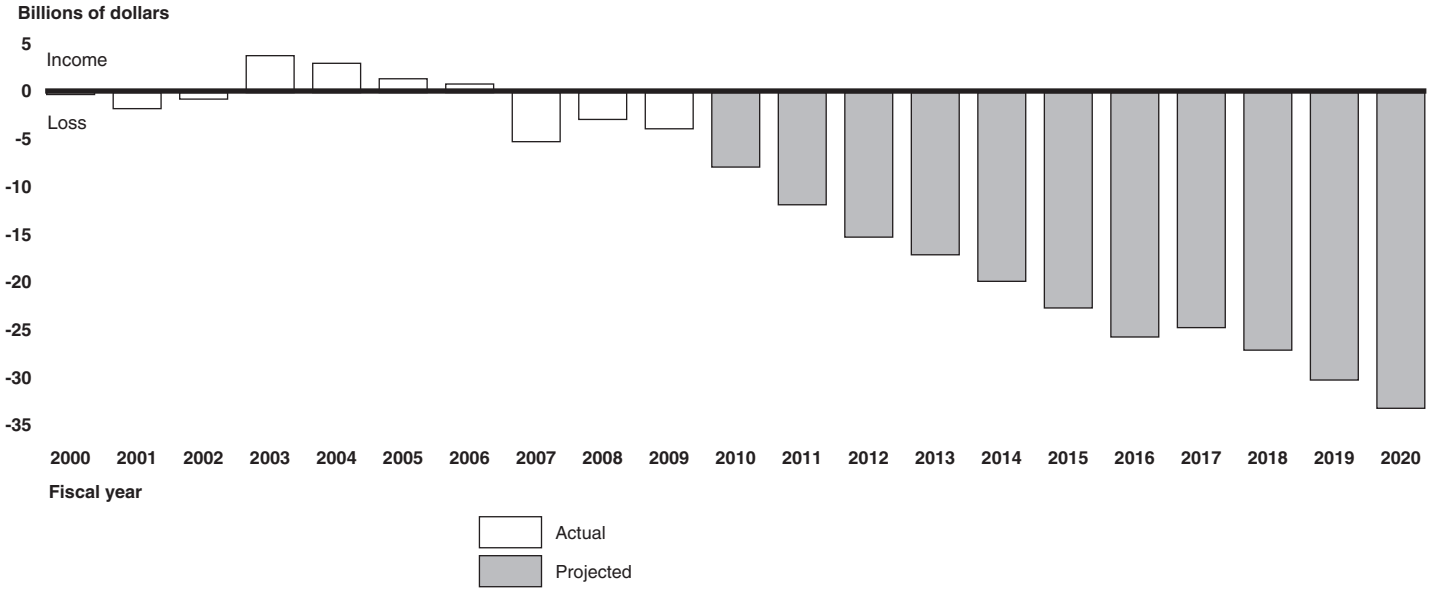
[1]GAO, *High-Risk Series, Restructuring the U.S. Postal Service to Achieve Sustainable Financial Viability*, GAO-09-937SP (Washington, D.C.: July 28, 2009).

[2]A looming cash shortfall in 2009 necessitated last-minute congressional action to reduce USPS's mandated payments to prefund retiree health benefits from $5.4 billion to $1.4 billion. Pub. L. No. 111-68, § 164, 123 Stat. 2023 (Oct. 1, 2009).

the annual statutory limit of $3 billion, bringing outstanding debt to $10.2 billion at the end of fiscal year 2009.

These declines along with large financial losses, increasing debt and financial obligations, are projected to continue to challenge USPS. Most recently, total mail volume for the first quarter of fiscal year 2010 was down almost 4.5 billion pieces, a decrease of almost 9 percent over last year. For fiscal years 2010 and 2011, USPS is projecting annual deficits exceeding $7 billion and additional pressures to generate sufficient cash to meet its obligations. Further, USPS has halted construction of most new facilities and has budgeted $1.5 billion in capital cash outlays (mostly for prior commitments), which is down from the average of $2.2 billion in the previous 5 fiscal years. USPS also expects to borrow $3 billion in fiscal year 2010, which would bring its total outstanding debt to $13.2 billion, close to its $15 billion statutory limit, which it could reach as early as fiscal year 2011. USPS projects that financial losses will escalate over the next decade, with cumulative losses of over $230 billion by fiscal year 2020 if its planned cost reduction and revenue generation initiatives are not implemented. (see fig.1).

Figure 1: USPS Actual and Projected Net Income (Loss), Fiscal Years 2000 to 2020

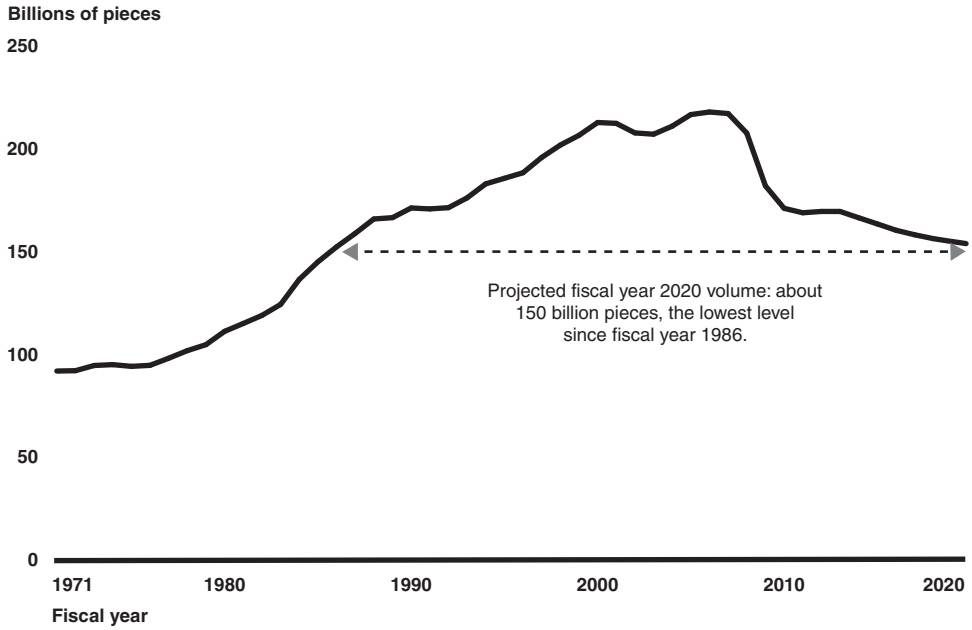


Source: USPS.

Note: The projection for fiscal year 2010 is from USPS's Fiscal Year 2010 Integrated Financial Plan. USPS projections for fiscal years 2011 through 2020 are from its plan and assume that (1) USPS takes no management actions beyond those in its fiscal year 2009 budget and (2) USPS's total statutory borrowing limit of $15 billion would be increased to accommodate these losses.

Further, USPS does not expect total mail volume to return to its former levels when the economy recovers. It projects that total mail volume will decline to 167 billion pieces in fiscal year 2010—a level not seen since fiscal year 1992, and 22 percent less than its fiscal year 2006 peak. By fiscal year 2020, USPS projects, at best, further volume declines of about 16 percent, to about 150 billion pieces, the lowest level since 1986 (see fig. 2).

Figure 2: Actual and Projected Total Mail Volume, Fiscal Years 1971 through 2020

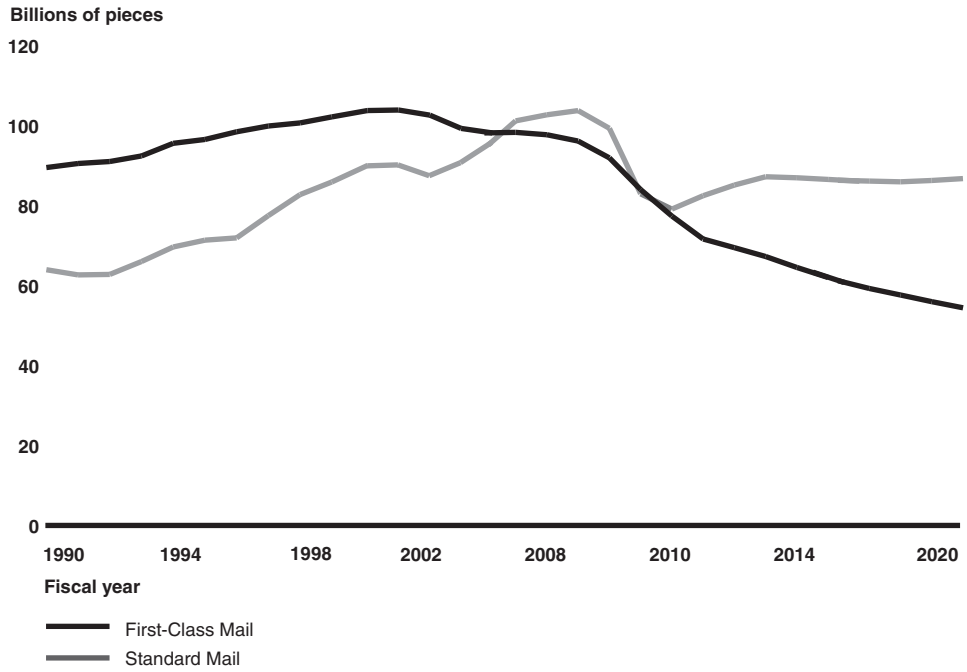


Source: USPS.

- First-Class Mail volume has declined 19 percent since it peaked in fiscal year 2001 and USPS projects that it will decline by another 37 percent over the next decade. (see fig. 3). This mail is highly profitable and generates over 70 percent of the revenues used to cover USPS overhead costs.

- Standard Mail (primarily advertising) volume has declined 20 percent since it peaked in fiscal year 2007, and is projected to remain roughly flat over the next decade. This class of mail is profitable overall but lower priced, so it takes 2.5 pieces of Standard Mail, on average, to equal the profit from the average piece of First-Class Mail. Standard Mail volume was affected by large rate increases in 2007 for flat-sized mail, such as catalogs, and the recession that affected advertising such as mortgage, home equity, and credit card solicitations. These solicitations appear unlikely to return to former levels. Standard Mail also faces growing competition from electronic alternatives, increasing the possibility that its volume may decline in the long-term.

Figure 3: Actual and Projected First-Class Mail and Standard Mail Volume, Fiscal Years 1990 through 2020



Source: USPS.

In addition to the projected losses caused by declining mail volume, USPS believes that stagnant revenue, costs of providing universal service, and rising workforce costs will also lead to losses.

USPS and Congress Need to Act Aggressively to Address Financial Crisis

USPS urgently needs to restructure to improve its current and long-term financial viability. On March 2, 2010, USPS addressed these issues in its plan, entitled "Ensuring a Viable Postal Service for America: An Action Plan for the Future,"[3] which identified seven key areas where-in it would need legislative changes or congressional support. Improving its financial viability is critical because USPS plays a vital role in the U.S. economy, and is at the core of a mailing industry valued at about a trillion dollars, according to USPS. Moreover, it is the largest civilian federal agency, employing approximately 599,000 career employees as of December 31,

[3]USPS's plan and related material are available at http://www.usps.com/strategicplanning/futurepostalservice.htm.

2009 and operating a total of about 38,000 facilities nationwide as of September 30, 2009.

We have previously concluded that restructuring is needed in multiple areas, including action and support by Congress, since no single change will be sufficient to address USPS's pressing challenges. According to USPS, even if it took all of the actions it could under existing law, it would still face unsustainable losses of at least $115 billion by 2020. A major challenge for USPS is to cut costs and restructure quickly enough to offset unprecedented volume and revenue declines—particularly costs related to its workforce, retail and processing networks, and delivery services—so that it can cover its operating expenses. We have an ongoing review, as mandated by the Postal Accountability and Enhancement Act of 2006,[4] to evaluate options and actions for the long-term structural and operational reforms of USPS. Due to the urgency of the USPS financial crisis, we plan to issue our study in April 2010, ahead of the December 2011 statutory deadline.

When we placed USPS's financial condition and outlook on our High-Risk List, we identified the following key actions USPS and/or Congress could take:[5]

1. Reduce compensation and benefit costs through

- *retirements*: Annually through 2020, about 5 percent of USPS employees will be eligible and expected to retire, according to USPS. That represents approximately 300,000 employees, about half of the workforce as of March 2, 2010.
- *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 the 600 mail processing facilities nationwide, where processing capacity for First-Class Mail exceeds processing needs by 50 percent.

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

[5]GAO-09-937SP.

- Maximize use of lower-cost retail alternatives: Approximately 30 percent of USPS retail revenue currently comes through alternate channels, such as stamps bought by mail, on the Internet, and at grocery stores, indicating that customers have begun shifting to such alternatives.
- Reduce the network of 36,500 retail facilities, where maintenance has been underfunded for years, resulting in deteriorating facilities and a maintenance backlog. USPS recently reported that it has more retail facilities than McDonalds, Starbucks, and Walgreens combined. Further, it stated that its post offices average about 600 visits per week, representing only 10 percent of average weekly visits to Walgreens.

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

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

In the past, we have also discussed, and the Postal Service has recently proposed, additional options for restructuring that would require congressional approval:

1. Change funding requirements for retiree health benefits: USPS asked Congress to revise the funding requirements for its retiree health benefit obligation. USPS had difficulty making its required payment to prefund retiree health benefits in fiscal year 2009 and has warned that it may have similar difficulty for fiscal year 2010. As noted, in fiscal year 2009, a looming cash shortfall led to last-minute congressional action to reduce USPS's required payments to prefund retiree health benefits from $5.4 billion to $1.4 billion.

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, stating that eliminating Saturday delivery would provide annual savings of about $3 billion.[6] The Postal Regulatory Commission (PRC) estimated in 2008 that eliminating Saturday delivery would result in

[6]USPS plans call for continuing providing window retail service and delivery to post office boxes on Saturday, as well as remittance mail service for business mailers.

savings of about $1.9 billion, based on somewhat different assumptions regarding the likely effects on mail volume and costs.

The Postmaster General stated in March 2010 that USPS plans to request a PRC advisory opinion on this change, which would lead to a public proceeding that would include input by interested parties. Before this plan could be implemented, Congress would need to stop including statutory restrictions contained in USPS annual appropriations that mandate 6-day delivery. Congress might wish to consider several questions regarding such a change:

1. How would eliminating Saturday delivery impact USPS's efforts to grow mail volume and encourage commercial mailers to continue using the mail?
2. How would eliminating Saturday delivery affect mail processing costs? Salary and benefits for mail processing employees and carriers?
3. What will be the expected effects on delivery service standards?
4. How will consumers and business customers be affected by a move to 5-day delivery? How does USPS plan to mitigate these effects?
5. How does USPS plan to communicate eliminating Saturday delivery and other related changes to mailers and the public?
6. Will there be sufficient P.O. boxes to handle a potential spike in demand for those customers wishing to pick up mail on Saturdays?
7. How much lead time would be needed for USPS to modify its operations and financial systems before eliminating Saturday delivery?
8. What other options has USPS considered that could significantly reduce costs without reducing delivery service?

These issues need to be addressed in the expected USPS 5-day delivery proposal so that stakeholders fully understand the potential ramifications of these changes. More broadly, USPS faces larger issues with regard to restructuring and its financial viability. The longer it takes for USPS and Congress to address USPS's challenges, the more difficult they will be to overcome.

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.

Contacts 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 Teresa Anderson, Tonnyé Conner-White, Colin Fallon, Brandon Haller, Margaret McDavid, and Crystal Wesco.

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