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Statement of Fredric V. Rolando Senate Appropriations Subcommittee on Federal Service and General Government March 18, 2010

Thank you, Chairman Durbin, for holding this important hearing on the financial situation facing the United States Postal Service. On behalf of the 295,000 members of the National Association of Letter Carriers, I submit this statement for the subcommittee's consideration.

Overview

There is no doubt that the Postal Service faces the worst crisis since the Great Depression of the 1930s. The collapse of the housing bubble and the financial meltdown of 2008-2009 affected the most mail-intensive sectors of the economy. This occurred at a time when the impact of electronic diversion of traditional letter mail caused mail volume to stagnate after peaking in 2006. Yet the deep recession and the negative impact of the Internet on postal volumes are not the most important causes of the Postal Service's large deficits in recent years. Unfortunately, the main driver of the USPS's current financial distress stems from a policy decision, albeit well-intentioned, adopted by the U.S. Congress in 2006 to require the Postal Service to massively pre-fund decades of future retiree health benefit obligations in just 10 years. This requirement has cost, and will continue to cost, the Postal Service some \$5.6 billion per year until the year 2016.

That's right. This immediate crisis was initiated in 2006 when Congress, in cooperation with the Bush administration, included the prefunding requirement in the Postal Accountability and Enhancement Act (PAEA). What appeared to be affordable in 2006 is clearly unaffordable today. Over the past three years, as the economy slipped into the worst recession in 80 years, the Postal Service has had to pony up \$12.4 billion to prefund future retiree health benefits – on top of some \$6 billion for current retiree health benefits.

No other agency – including the United States Congress – or private company faces such a legal obligation to prefund. Indeed, such prefunding is not even required by the Financial Accounting Standards Board (FASB), which establishes accounting rules for both private and public organizations. And as an annual survey conducted by Watson Wyatt found in 2009, only about a third of Fortune 1000 companies voluntarily

prefund retiree health obligations at all – and those that do have set aside much less than the Postal Service has already.¹

What makes this situation worse is that the size of the prefunding payments is grossly inflated due to actuarial methods adopted by the Office of Personnel Management (OPM). These methods, which have been exposed by a series of reports by the Office of Inspector General of the USPS, not only shortchanged the Postal Service Retiree Health Benefits Fund (PSRHBF) by tens of billions of dollars when it was established in 2007, but also greatly exaggerated the USPS's future liability for retiree health benefits – which prompted the Congress to establish a completely unrealistic schedule of prefunding payments in the PAEA.

The USPS has responded with tremendous resilience to the challenges of the recession, which began in 2006 for our industry when the credit crunch hit. And my union, the NALC, has been a responsible and reliable partner in helping it react to the steep decline in mail volume. Working together at the bargaining table, we strove to negotiate flexible and fair means for adjusting all 160,000 city carrier routes to ensure eight-hour assignments, boosting efficiency and saving hundreds of millions of dollars. In fact, we adjusted every city carrier route in the country not once, not twice, but three times over the past 18 months. Using the traditional method of route evaluation would have taken more than five years to adjust every route.

In fact, the Postal Service has been so successful in cutting costs to align work hours with recession-level volumes that it would have earned a net surplus of \$1.6 billion over the past four years in the absence of the onerous prefunding burden. This burden is directly responsible for the dramatic rise in the Postal Service's outstanding debt. See the chart below.

Prefunding Payments, Net Income and Debt of the U.S. Postal Service (\$billions)			
<u>Year</u>	<u>Payments to the Postal Service Retiree Health Benefits Fund</u>	<u>Net Income</u>	<u>Debt Increase</u>
2006	\$0.0	\$0.9	\$2.1
2007	\$5.4	-\$5.1	\$2.1
2008	\$5.6	-\$2.8	\$3.0
2009	\$1.4	-\$3.8	\$3.0
Totals	\$12.4	-\$10.8	\$10.2
Notes: (1) A modified version of H.R. 22 was enacted in 2009, slashing the prepayment from \$5.4 to \$1.4 billion; (2) In 2005 the Postal Service had no debt at all.			

Congress Should Fix the Prefunding Policy First

Today your sub-committee is going to hear a lot about 10 and 20-year predictions about future mail volume and the mega-sized postal deficits that will occur if we do nothing. You will no doubt also be asked to embrace draconian suggestions developed by the Postal Service's consultants and perhaps other witnesses. The 200,000 men and women who deliver the mail on city carrier routes today urge you exercise great caution and to stop and consider the real cause of the immediate crisis: The unworkable and unreasonable pre-funding policy adopted in 2006.

Congress should correct the retiree health prefunding policy first -- it is the single most effective step you can take to stabilize the Postal Service's finances. We urge you to fully implement the recommendations contained in the two OIG reports on this issue.ⁱⁱ (See the attached fact sheets prepared by the NALC's Department of Legislative and Political Affairs.) While we appreciate the efforts undertaken last year in by the Obama administration and other Senate leaders to offer limited relief from the pre-funding burden in S. 1507, that bill does not go far enough and its adoption by the Senate Committee on Homeland Security and Governmental Affairs was marred by an anti-union amendment that would permanently and unfairly tilt the interest arbitration process in favor of postal management. NALC urges the Senate to start over with a fresh approach suggested by the USPS OIG.

Congress Should Retain Six-Day Delivery

The Postal Service is too important to the country to make rash decisions in an environment of financial distress. NALC believes it would be unwise to downsize to meet recessionary levels of demand before we know how soon and how well the economy and the postal market will recover. Specifically, we believe that eliminating Saturday collection and delivery services would be penny-wise and pound-foolish. No business has ever restored itself to health by offering slower service and turning customers away – too many businesses (including mail order merchants, online pharmacies, DVD and game rental companies and newsmagazines) rely on six-day delivery to simply leave them in the lurch. Rather than saving the Postal Service money, five-day delivery could worsen its bottom line over time as a result of further volume and revenue losses. And it would needlessly destroy 50,000 good jobs at a time of extremely high unemployment. (See the attached fact sheet on Saturday delivery prepared by the NALC's Department of Legislative and Political Affairs.)

Eliminating Saturday collections and delivery should be a last resort policy, not a first resort policy. It certainly should not be considered until we see the impact on demand for postal services when the economy recovers – as well as the results of the next round of postal collective bargaining. Nor should it be considered before Congress corrects the deeply flawed prefunding policy adopted in 2006. In any event, the Postal Service has not yet presented its five-day collection and delivery proposal to the PRC for review, as mandated by law. Congress and this sub-committee should await the results of that review and conduct extensive hearings to ensure it understands the full

implications of eliminating Saturday delivery before debating changes to the annual appropriation legislation that mandates six-day services. The data and assumptions in the Postal Service's plan yet to be scrutinized and special attention must be given to the impact of service cutbacks on tens of millions of small businesses, including those in rural communities and economically distressed neighborhoods.

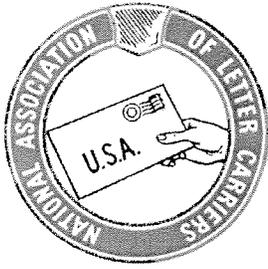
Conclusion

We know that prefunding reform may not be enough to secure the long-term viability of the USPS. We know the Postal Service's business model deserves a serious and comprehensive debate. However, NALC and the other postal unions are prepared to deal with the lingering effects of the recession and the negative impact of the internet at the negotiating table, just as we have adapted to varying business conditions for some 40 years of successful collective bargaining. And we believe that it is only in the context of financial stability that a serious and careful legislative debate can take place. That will require us to do our part at the bargaining table and for Congress to do its part on retiree health prefunding reform.

NALC is committed to preserving a strong and viable Postal Service that can meet the evolving needs of the American people and American businesses. We look forward to working with this sub-committee and the entire United States Senate to find a sensible and realistic way forward. Thank you for inviting us to submit this statement.

ⁱ See Figures 29 and 30 in "Accounting for Pensions and other Postretirement Benefits 2009, Reporting Under FAS 87 and FAS 106 Among the Fortune 1000, A Watson Wyatt Survey Report," pages 21-22.

ⁱⁱ USPS Office of Inspector General study: "The Postal Service's Share of CSRS Pension Responsibility," January 22, 2010, see http://www.uspsoig.gov/foia_files/RARC-WP-10-001.pdf; and USPS Office of Inspector General report: "Estimates of Postal Service Liability for Retiree Health Benefits (Report Number ESS-MA-09-001(R)), July 22, 2009, see http://www.uspsoig.gov/foia_files/ESS-MA-09-001R.pdf.



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March 5, 2010

Strengthening the Postal Service: Reform its Retiree Health Pre-funding Schedule

The Postal Service is facing a financial crisis in the midst of the worst recession in 80 years. Congress spent much of 2009 debating short-term financial relief for USPS in the form of reduced prefunding payments for future retiree health benefits. On September 30, 2009, Congress adopted a measure which reduced the level of USPS prefunding in 2009 from \$5.4 billion to \$1.4 billion and reduced the Postal Service's operating loss from \$7.7 billion to \$3.7 billion. While it was helpful last year, this type of last-minute relief will not adequately address the larger problems caused by the prefunding requirements. In 2010, Congress must reform the prefunding schedule adopted by Public Law 109-435 to provide for long-term financial stability. The current schedule is unaffordable and unfair:

1. The USPS is the only enterprise in the country required by law to prefund retiree health benefits while most Fortune 1000 companies (two-thirds) don't prefund at all.
2. The annual payments required are extremely onerous, requiring the USPS to effectively prefund 80 percent of a 75-year liability in just 10 years, and are based on flawed calculations by the Office of Personnel Management (OPM).
3. The actuarial methods used to determine the retiree health benefit liability are deeply flawed and inequitably overstate the Postal Service's liability. Congress should mandate a new prefunding schedule based on fair and accurate actuarial calculations.

Background on Prefunding

The Postal Accountability and Enhancement Act of 2006 established the Postal Service Retirees Health Benefit Fund (PSRHBF) by calling on OPM to calculate the "postal" surplus in the Civil Service Retirement System and to transfer it to the PSRHBF in 2007. The law also dictated 10 annual payments into the Fund averaging \$5.5 billion each between 2007 and 2016, also based on OPM calculations.

In establishing the Fund and setting the payment schedule, Congress sought to minimize the "budget score" of the legislation and re-

lied on the OPM estimates of the value of the CSRS surplus and the cost of future retiree health benefit liabilities. A study conducted by the USPS Office of Inspector General shows that OPM underestimated the size of the postal CSRS pension surplus by roughly \$75 billion.¹ Furthermore, the Postal Regulatory Commission has found that OPM's health care inflation assumptions are overstated.² As a result of these calculations, the Postal Service has been saddled with an unaffordable prefunding schedule that threatens its future viability.

A Fair Calculation of the Postal CSRS Surplus

In 2003, OPM made the initial determination of the postal pension surplus in order to implement a CSRS funding reform law (P.L. 108-18). This process, which was repeated in 2007 under the PAEA (with the Treasury taking responsibility for CSRS military benefits), required the OPM to allocate the cost of CSRS benefits earned by postal employees between the Treasury (taxpayers) and the Postal Service (ratepayers) for all workers who performed service before and after July 1, 1971. That was the day the Post Office Department (POD) was reorganized and became the U.S. Postal Service, an independent agency of the government separate from other cabinet agencies. Unfortunately, OPM shifted much of the cost of CSRS benefits earned by POD employees to the Postal Service by making the USPS responsible for any and all increases in the value of benefits accrued for POD service due to wage increases after July 1, 1971. Any fair calculation of benefits accrued before postal reorganization in 1971 should have included some recognition of normal wage increases in the future, since CSRS benefits are based on end-of-career earnings. Instead, OPM froze the value of accrued benefits at July 1, 1971, pay levels—effectively shifting much of the cost of pre-reorganization service to the Postal Service. The OPM also failed to recognize that the CSRS benefit formula is back-

¹Postal OIG study, "The Postal Service's Share of CSRS Pension Responsibility". 20 Jan. 2010. http://www.uspsig.gov/foia_files/RARC-WP-10-001.pdf

²Postal Regulatory Commission study, 30 July 2009. http://www.prc.gov/Docs/63/63987/Retiree%20Health%20Fund%20Study_109.pdf

loaded and unfairly assigned the low-cost early years to the POD and the high cost later years to the Postal Service.

By overstating the Postal Service's liability for CSRS benefits, the OPM understated the value of the postal surplus in the CSRS by as much as \$75 billion, according to a review by the OIG. As a result, the Postal Service was short-changed when the surplus was transferred to the PSRHB in 2007. Under OPM's method, the fund was credited \$17 billion. Using the more fair and accurate method advanced by the OIG, however, the postal surplus may have exceeded \$80 billion, more than enough to cover all of the Postal Service's future retiree health liability.

Adjusting the OPM's Health Inflation Rate

The OPM has also inflated the cost of the Postal Service's prefunding payments by assuming an extremely high rate of long-term health care inflation—some 7 percent annually for 75 years. Most Fortune 1000 companies use a 5 percent long-term rate, while Medicare and Medicaid assume costs will rise by 6.25 percent annually. Both the Inspector General and the PRC have concluded that more accurate inflation assumptions could reduce or eliminate the Postal Service's PAEA-required payments. The OIG's report concluded that “[t]he

Postal Service could pay an average of \$4 billion less each year from FYs 2009-2016 to prefund its retiree health benefits and still achieve the same level of prefunding [80%] anticipated under OPM assumptions.”

The current long-term cost assumption is inaccurate and places an unfair burden on the Postal Service, its employees and ratepayers. It must be adjusted to more accurately reflect the reality of the Postal Service's future obligations.

Eliminating Saturday Delivery Not the Answer

Correcting OPM's actuarial calculations involving the CSRS postal surplus and the long-term cost inflation rate would significantly reduce the \$5.5 billion prefunding payments mandated by the Postal Accountability and Enhancement Act of 2006. It would also strengthen the financial stability and future viability of the Postal Service.

Adopting a more accurate and affordable prefunding schedule should be given the highest priority in any postal reform legislation considered during the remainder of the 111th Congress. This step should certainly be taken before Congress considers more radical measures such as the elimination of Saturday delivery.



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March 9, 2010

Save the Postal Service: Demand Fairness in USPS Pension and Retiree Health Funding

As the economy struggles to recover from the worst recession in 80 years, the Postal Service continues to face a financial crisis. The loss of revenue resulting from declining mail volume is compounded by a provision in the 2006 postal reform that requires the Postal Service to massively pre-fund its future retiree health benefits at a cost of \$5.6 billion annually. The requirement has resulted in mounting losses, rising debt and destructive job and service cuts.

The unprecedented prefunding provision—no other agency or private enterprise is required to prefund by law or by widely accepted accounting standards—was made worse by how it was implemented by the Office of Personnel Management. The OPM's calculations to determine the initial balance in the Postal Service Retiree Health Benefit Fund (PSRHBF) and the size of the Postal Service's future retiree health liability were deeply flawed. Studies conducted by the Office of the Inspector General of the Postal Service (OIG)¹ and the Postal Regulatory Commission² have shown that the "postal surplus" in the CSRS pension fund, which was transferred to the retiree health fund in 2007, was grossly undervalued by OPM. As a result, USPS was shortchanged by as much as \$75 billion when the PSRHBF was created.

Returning these surplus funds to the postal retiree health fund would greatly alleviate the Postal Service's financial stress. In fact, doing so would fully fund the Postal Service's 75-year liability for future retiree health benefits and the current prefunding requirements would be unnecessary.

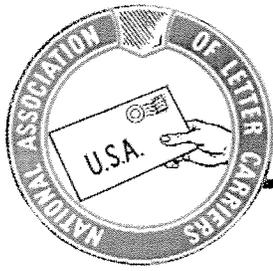
In 2010, in order to rectify the unfair, inequitable and financially destructive impact of the prefunding policies resulting from the OPM's methods, Congress must:

1. Demand that OPM recalculate the postal pension surplus using actuarial methods that are fair to the Postal Service and its ratepayers, as proposed by the OIG;
2. Require that OPM transfer the corrected surplus fund to the Postal Service Retiree Health Benefits Fund; and
3. Repeal the prefunding requirement found in *Section 8909a* of Public Law 109-435.

The long-term viability of the USPS will require all stakeholders to adapt and innovate and may require Congress to adopt further legislative changes to allow the Postal Service to provide new services and to generate new revenue. But reform of the prefunding provisions cannot wait until a consensus forms on a new business model. Congress must act this year.

1. USPS Office of Inspector General report: Estimates of Postal Service Liability for Retiree Health Benefits (Report Number ESS-MA-09-001(R)). See http://www.uspsoig.gov/foia_files/ESS-MA-09-001R.pdf.

2. Postal Regulatory Commission Review of Retiree Health Benefit Fund Liability as Calculated by the Office of Personnel Management and the U.S. Postal Service Office of Inspector General, July 30, 2009. See www.prc.gov/Docs/63/63987/Retiree%20Health%20Fund%20Study_109.pdf.



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January 29, 2010

Eliminating Saturday delivery is not the answer

The U.S. Postal Service faces the worst crisis in its history. It expects to lose \$6-\$7 billion in 2009. Although the collapse of the housing and financial sectors in late 2008 is responsible for the largest decline in mail volume since the Great Depression in the 1930s, the main cause of the financial crisis is the decision advanced by the Bush administration in the postal reform law of 2006 to require the USPS to prefund its **future** retiree health benefits, a 75-year liability, in just 10 years. The cost of this unaffordable prefunding payment, \$5.4 billion in 2009, accounts for most of the projected loss this year. The annual cost will rise to \$5.8 billion by 2016. While the NALC is working with postal management to address the crisis with the Interim Route Adjustment Process, Congress must take action to relieve this prefunding burden to preserve affordable, universal service. See the NALC Fact Sheets on H.R. 22 and S. 1507.

Postal management's proposal to deal with the crisis—eliminating Saturday mail delivery—is not a sensible solution to the USPS's financial crisis.

The Postal Service estimates that by eliminating one-sixth of its delivery service, it can cut operating expenses by \$3.4 billion or 4.6 percent—not the 16.6 percent you might expect. The model it used to estimate potential savings is based on many unproven assumptions and did not specifically study the elimination of Saturday delivery, the day most Americans are home to receive packages.

To date, no study has been conducted to estimate how a reduction in delivery days would affect mail volume and delivery costs in the remaining five days or how different types of mailers would be affected.

A study conducted on behalf of the Postal Regulatory Commission suggests that total cost savings by eliminating one of delivery could be as low as \$1.9 billion or just 2.5 percent of total postal expenses.

The Postal Service is rushing to judgment.

In letters to employee groups dated June 11, 2009, USPS management requested input on a study of the feasibility of weekday-only delivery with replies due back by June 19, 2009. In July it informed the unions that it planned to finish its review in three weeks. The USPS appeared to be recycling an old IBM study it used for the PRC Universal Service investigation. A more thoughtful and serious study is needed.

The proposed reduction in delivery services would be the most radical change to postal operations in the 230-plus year history of the U.S. Mail. No such policy decision should be made after just a few weeks consideration, much less without a comprehensive study of its effects.

Six-day delivery makes the Postal Service unique.

One of the defining characteristics of the U.S. Postal Service is its policy of nation-wide uniform pricing with six-day delivery. Competitors charge don't deliver or charge high premiums for Saturday delivery while the USPS provides affordable universal as mandated by the Constitution.

American businesses value six-day delivery.

Business in the United States is conducted six days—and in many sectors seven days—per week. Small and large businesses alike, from individual entrepreneurs to large-scale financial firms, rely on the delivery of the mail six days per week to operate successfully. Saturday delivery is especially important to growing companies like eBay, Netflix and Caremark, and has long been vital for news magazines. The elimination of Saturday delivery will make the USPS less valuable to business and accelerate electronic substitution.

American citizens value Saturday delivery too.

Billions of prescriptions are delivered through the mail each year—a two-day delay in their delivery would seriously inconvenience senior citizens and others. Delayed delivery of payments, subscriptions and food products would adversely affect millions of households.

Rural communities would be disproportionately affected.

Americans living in rural areas where the Postal Service's competitors do not deliver or where broadband connectivity is not available rely especially on six-day USPS delivery and would be adversely affected by any service cuts. Farmers rely on the delivery of seeds and other products through the mail and citizens who live far from retail outlets need the USPS for mail-order delivery.

Broad coalition of stakeholders favors six-day delivery.

According to the PRC's 2008 study of universal service, parcel shippers, direct marketer, magazine publishers and other major mailers along with consumer advocacy groups and the seven postal employee groups agreed: The elimination of six-day delivery would hurt business and consumer interests while costing thousands of jobs.