TESTIMONY OF
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BEFORE THE
SPECIAL PANEL ON POSTAL REFORM AND OVERSIGHT
COMMITTEE ON GOVERNMENT REFORM
UNITED STATES HOUSE OF REPRESENTATIVES
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Chairman McHugh and members of the Special Panel, I welcome the opportunity to meet with you today to discuss the very real need for comprehensive reform of the legislative framework governing the Postal Service. For a number of years, Chairman McHugh, other members of this Panel and the Committee on Government Reform have recognized that fundamental change is necessary to protect the right of affordable, universal mail service for everyone in America. In addition to Chairman McHugh, I particularly want to recognize Committee Chairman Tom Davis and Representatives Dan Burton, Henry Waxman and Danny Davis for their work on this issue.

Their efforts resulted in in-depth explorations of the economic factors and market dynamics that, in the long term, threaten the ability of the Postal Service to carry out its mission successfully. More significant, they were willing to propose solutions in the form of legislation that would modernize the 34-year-old law that established the Postal Service.

We are grateful for those efforts to address this situation before it results in a crisis. As Chairman McHugh has said often, “the time to fix the roof is now, before it rains.” I agree.

Chairman McHugh’s leadership and forward thinking have helped to educate the entire postal community on this issue. And the action of the President in creating a Commission on the United States Postal Service has complemented those actions.

As you have heard from S. David Fineman, Chairman of our Board of Governors, both the Governors and management of the Postal Service support modernization of the charter that created the Postal Service. We also understand that in today’s extremely challenging communications market we must manage our business as effectively as possible.

That is what we are doing. Since I assumed the role of Postmaster General, transformation of the Postal Service has been our central focus. And I am pleased that the President’s Commission on the Postal Service acknowledges that our Transformation Plan is guiding us to substantial progress in adapting to an uncertain future. Clearly, it is taking us in the right direction.

While the Transformation Plan became our organizational vision in 2002, the ongoing process of transformation began before then through our breakthrough productivity initiative. The year 2000 marked the first of a record four straight years of increases in total factor productivity.

We have reduced our career employee complement by over 80,000 – a ten percent reduction from its peak level in 1999. Only 70 American companies have as many as 80,000 employees on their rolls.

We have delivered $5 billion in cost savings since 2000. This includes $2.7 billion in savings resulting from Transformation Plan initiatives over the past two years. We are on track to surpass the $5 billion in savings called for by the Transformation Plan over the five-year period ending in 2006.

Consistent with our Transformation Plan goal of enhancing a performance-based culture, we have established pay-for-performance systems for managers, executives, postmasters and supervisors. The new system links 100 percent of pay increases to performance. We have brought service performance and customer satisfaction to their highest levels. We have improved the workplace environment, measured both by reductions in grievances awaiting arbitration and quarterly employee surveys. We are aggressively managing the business. This will not change.

In addition to the Transformation Plan strategies that have contributed to these successes, the recent legislation adjusting the Postal Service's payments to the Civil Service Retirement System helped us achieve a welcome and needed level of financial stability.

Without the correction provided by this legislation, the Office of Personnel Management and the General Accounting Office found that the Postal Service could have overpaid its obligation by $105 billion, costs that would otherwise have been borne by every user of the mail through the price of postage. We are particularly grateful for the understanding and cooperation of Chairman Davis and the Committee on Government Reform, as well as the administration and the General Accounting Office for their prompt action in addressing this problem.

By immediately reducing costs related to funding the Civil Service Retirement System, this legislation will allow us to hold rates steady until 2006. This legislation has contributed to our ability to reduce outstanding debt by more than one third – from $11.1 billion to $7.3 billion – in fiscal year 2003. We will continue to take advantage of the new CSRS payment schedule to reduce debt even more this fiscal year. This same legislation, however, presents very definite challenges, which I will also address today.

In the near term, the CSRS legislation has resulted in a welcome period of financial stability. Within that context, we have the opportunity and the obligation to develop the right solutions to the challenges facing the nation's mail system so that every family and every business in America continues to enjoy – and benefit from – affordable, universal mail service.

It is important that I take a moment to acknowledge that the success of the Postal Service over the last three decades is largely a result of the new business model that was created by the Postal Reorganization Act of 1970. The Postal Service is self-sufficient. Postage rates have largely tracked the rate of inflation. And, by the end of this fiscal year, we will have achieved the Act's mandate that the Postal Service "break even" over time.

Yet, as we continue to improve efficiency, we recognize that opportunities for savings and improvement will grow increasingly limited. New tools will be necessary.

Many – in the Postal Service, the mailing community, and in Congress – have long recognized that, despite the success made possible by the 1970 Act, the business model it created is becoming increasingly disconnected from today's reality. It is outdated and inflexible. The Postal Reorganization Act was predicated on the assumption – valid for most of the last 34 years – that continually growing mail volume would result in continually increasing revenue. That revenue, in turn, would be sufficient to cover the costs of an expanding service network. This is no longer the case.

The productivity improvements of the last few years, coupled with reduced pension payments resulting from the CSRS legislation, have masked the need for change in the Postal Service. The need for change may not become apparent to everyday mail users until the inflexibilities of our dated business model begin to affect service and the price of postage. We cannot afford to let this happen.

The facts speak for themselves.

Mail volume has declined in each of the last three fiscal years, dropping more than five billion pieces from its peak in 2000. This represents $4.5 billion less in revenue. During the same three-year period, the number of addresses we serve increased by 5.4 million. This combination of factors – declining mail volume contrasted with the costs of a still-growing service network – resulted in a net loss in three of the last four years.

In 2003, extremely focused efforts in managing our business and the impact of the Civil Service Retirement System payment reform legislation, combined to result in a net income of $3.9 billion. Even without the welcome relief of the CSRS legislation, continued cost reductions and increased productivity would have resulted in a net income of $900 million. This was, in itself, a 50 percent increase over plan.

Of course, a number of external factors contributed to mail volume losses since 2001. These included the 9/11 terrorist attacks, the use of the mail for bioterrorism and, most significantly, the effects of a difficult economy.

But, as Chairman McHugh's pioneering work has validated, profound structural changes are also at work. These include the increasing use of electronic communications for transactions that, in the past, had almost universally taken place through the mail. The robust growth of private-sector delivery services – from packages to time-sensitive communications – has also altered the competitive landscape. These factors will contribute to a diminished rate of mail volume growth as our delivery infrastructure – and its associated costs – continues to expand.

This will place extreme pressure on our bottom line. Significantly, volume trends indicate that First-Class Mail, which provides the greatest contribution to supporting system overhead, may continue its decline. In fact, in 2003 First-Class Mail volume was less than half of our total mail volume – for the first time in our history.

President Bush's creation of a Commission to examine the Postal Service was an important acknowledgement of the forces driving the need for change. I thank the Administration for its willingness to take on this critical public policy challenge sooner rather than later. The Commission's report, defining a proposed vision for the future and recommending legislative and administrative reforms needed to ensure the vitality of postal services for the American people, adds greatly to this important conversation.

In particular, I would like to recognize the efforts of the Treasury Department for its role in implementing the President's mandate. In addition, Commission Co-Chairs James Johnson and Harry Pearce – and all of the Commissioners – are to be commended for their focus and dedication to this task. They understood the need to define a new business model to protect the ability of the government to provide this vital service without undue expense to taxpayers or to postal ratepayers. Most importantly, they understood the need to act before there is a crisis that imposes hardship on the public.

Last month, the President urged Congress to enact postal reform legislation based on the five key principles contained in the Commission's final report.

The President's first principle is that a new legislative charter should implement best practices. It should ensure that the Postal Service's governing body is equipped to meet the responsibilities and objectives of an enterprise of its size and scope.

In this area, the Commission recommends significant changes to our governing board. The nine Governors of the Postal Service are today appointed by the President with the advice and consent of the Senate. The law requires that no more than five may belong to the same political party. This has allowed the Postal Service to enjoy bipartisan oversight for the last three decades.

We are concerned that the Commission's proposed new Board of Directors could change this. The President would appoint three Board members. They, in turn, would select the first eight independent Board members, with the concurrence of the Secretary of the Treasury. After that, independent members would be selected by the Board as a whole, with the concurrence of the Secretary of the Treasury.

There would be no limits on the political affiliation of Board members, and only the President or the Secretary of the Treasury could remove them. This could result in a highly-partisan Board. Moreover, the Senate's current statutory role of "advice and consent" in connection with Board appointees would be eliminated.

I ask that you keep these points in mind as you proceed with your consideration of this issue.

The Commission's report also recognized that the Postal Service should take advantage of corporate best practices that are necessary for long-term success in serving the nation.

In this regard, we have established and will continue the pursuit of strategic partnerships with the private sector where they help us enhance efficiency, reduce costs or improve service. Areas under review include mail transportation, retail operations, delivery service, and many other activities that support our core business.

We will continue to work with the mailing industry to encourage and support the expansion of worksharing where it makes sense. This provides mailers with strong financial benefits encouraging the use of mail and contributes to more efficient operations for the Postal Service.

We will continue more innovative approaches to how we buy products and services. Our transition to master buying agreements in key areas has saved $200 million in fiscal year 2003 alone. We will pursue every opportunity to benefit by similar agreements in as wide a range of buying activities as possible. While we face statutory limitations on some of our buying activities, we will also revise our purchasing regulations, within the scope of existing legislation, to reflect corporate best practices that can improve our operating and administrative practices and ensure that we receive maximum value with every purchase.

The second guiding principle identified by the President is transparency. This would ensure that important factual information is made available to the public in a timely manner.

While the President's Commission noted that, in many respects, our reporting often exceeds what is required of Federal agencies, the Commission recommends that our reporting match the level of disclosure offered by our corporate peers. As you have heard from Chairman Fineman, the Postal Service is making significant progress in enhancing its financial reporting in a number of key areas. These include annual and quarterly financial reports and enhanced disclosure and reporting of significant events. Management will continue to follow the guidance of the Postal Service governors in this important area.

The third principle of reform identified by the President is flexibility. This would ensure that the Postal Service's governing body and management have the authority to reduce costs, set rates, and adjust key aspects of its business in order to meet its obligations to customers in a dynamic marketplace.

In short, management needs the flexibility to manage. From my standpoint, I consider this the litmus test for postal legislative reform.

We agree with the Commission that the Postal Service must have the flexibility to alter its retail and processing networks to meet changing customer needs, provide increased access and achieve greater operational efficiency. Yet the Commission's proposed Postal Network Optimization Commission could take away the Postal Service's existing authority to better integrate and align its network.

Clearly, the expertise gained from day-to-day operation of the Postal Service's network should play a substantive role in any decisions to change that network, including any decisions to consolidate or close processing facilities. Despite the rationale for its establishment, we believe that any proposed network optimization process will lead to office-by-office or facility-by-facility decisions, and, therefore, are more local than national decisions.

The Commission's recommendations on rate setting would remove the determination of how much money is needed to run the nation's postal system from the operators – those with the day-to-day responsibility of running the postal system – and transfer it to the proposed Postal Regulatory Board. This would occur through the new rate-setting mechanisms recommended by the Commission. At the very least, those provisions should recognize that the Postal Service is a labor-intensive industry which operates as part of our economy's service sector.

We agree that there should be separate processes for pricing non-competitive and competitive products and services. However, we believe that more work needs to be done to ensure that the definitions of non-competitive and competitive products carefully reflect marketplace reality.

Another of the President's reform principles is a self-supporting Postal Service. This is intended to ensure that a Postal Service operating with greater flexibility is financially self-sufficient, covering all of its obligations.

Over the last few years, we have seen a growing consensus, within the mailing community and through previous postal legislative reform efforts, for a pricing structure that will increase rate predictability for customers and provide management with additional flexibility to respond to market needs, while covering its costs. Certainly, the establishment of a new rates process that provides management with greater flexibility will come with increased regulation to assure that there are no abuses of monopoly pricing. Price caps are under consideration as a tool to protect customers. They must also protect the Postal Service.

A properly constructed price-cap proposal can contribute to accomplishing these goals. But we caution that such a cap must be carefully constructed so that it succeeds in driving maximum operational efficiency, but does not undermine the legitimate financial needs of the organization and the level of service provided.

To be effective, a price cap must rely on projections. In a stable market, such projections may be reasonably accurate. In today's dynamic communications and delivery environment, it could be difficult – if not impossible – to accurately forecast cost and revenue trends for the extended period that would be covered by a price cap. Without some level of surety behind the projections, actual market conditions could quickly render a price cap ineffective.

As an example, let us examine some relatively recent mail volume assumptions. At the beginning of fiscal year 2001, the Postal Service published its *Five-Year Strategic Plan* for fiscal years 2001 through 2005. Management projections contained in the Plan built upon work undertaken in conjunction with government and private-sector experts. That Plan recognized the potential for diversion of some mail volume to electronic communications over time.

Based on historical trends, the Plan projected total mail volume of 230 billion pieces for fiscal year 2004. Even with the Plan's "rapid diversion" scenario, we projected that mail volume would be 213 billion pieces in 2004.

Today, using a likely "baseline" scenario that assumes a delayed economic recovery and current rates of electronic diversion, our 2004 projection calls for 204.3 billion pieces of mail. A "pessimistic" forecast, based on a longer-term economic slump and an increased rate of diversion, projects mail volume of only 202 billion pieces in 2004.

We acknowledge, of course, the unanticipated consequences of the terrorist attacks of 2001 and their magnifying effects on an already cool economy. However, the outlook for mail volume and revenue growth for the next five years is less promising than the period covered by the previous *Strategic Plan*. Major mail categories have experienced the greatest volume declines since the Great Depression, and are expected to be weak into the future. While it is still not clear how much of the volume loss is due to the current business cycle and how much is due to more lasting factors of technological change and competition, there is ample evidence that both forces are at work.

In short, a price-cap regime could bring some level of relief to a rate-setting process that severely limits our ability to respond to real-time market dynamics. At the same time, we strongly believe that marketplace uncertainties mandate that a price cap be just one element of comprehensive reform legislation that provides the Postal Service with flexibility in other critical areas that could offset a the limitations of a price-cap rendered less effective by unanticipated circumstances.

As an organization, we have reduced debt by more than one third. We are close to achieving our "break-even" mandate, eliminating the negative equity that has accumulated over the last three decades. We have become more productive and efficient than ever. We cannot risk these very real financial accomplishments, and their benefits to all mail users, by relying only on a limited reform strategy of price caps.

Success in the area of self financing would also involve our ability to retain earnings. We agree with the Commission that the Postal Service should have the opportunity to retain earnings – as requested in our Transformation Plan. This would provide a revenue stream that could finance capital expenditures and "smooth out" business cycle impacts on overall financial performance. Yet there must be safeguards so that severely limiting price caps do not serve as an artificial barrier to achieving retained earnings, and that retained earnings are sufficient to achieve their purpose.

Financial self sufficiency may also require additional flexibility in product and service offerings. We agree with the Commission, generally, in its description of the Postal Service's core mission: offering products and services directly related to the delivery of letters, newspapers, magazines, advertising mail and parcels. But we do have concerns about the Commission's recommendation that the Postal Service be limited by statute to only those activities. We are facing an uncertain future. The Commission's own projections call for a mail volume decline of five percent by 2017, and, for that same year, a Postal Service deficit of $8.5 billion. We strongly believe that it is necessary for the Postal Service to maintain the flexibility to pursue appropriate revenue streams to protect our ability to provide universal service. Our intention is that any such activity would be in areas related to our core business.

The President's five principles for reform also include accountability. There can be no objection to providing that a Postal Service operating with greater flexibility has appropriate independent oversight to protect consumer welfare and universal mail service.

The Commission proposes that this oversight be largely provided by a new Postal Regulatory Board, with discretionary policy authority in a wide range of areas, to replace the current Postal Rate Commission, which has a more limited mandate.

We understand the rationale for the discretion the President's Commission has defined for the Postal Regulatory Board. Yet regulators are normally required to operate within limits and guidelines. Regulated private companies and their shareholders have legal protections against arbitrary action by the regulator that the Postal Service would not have under a Postal Regulatory Board model.

For instance, a Postal Regulatory Board, as envisioned by the Commission, can revisit the vital national issues of the postal monopoly and universal service. From the perspective of the Postal Service, these are clearly issues of broad public policy. They are not regulatory issues. Without defined limits or guidelines, the regulator could conceivably limit the monopoly in such a way as to jeopardize universal service or even redefine the scope of the nation's mail service itself.

We agree with the Commission that the letter and mailbox monopolies are essential to support a universal service mandate. Yet the Commission would give a Postal Regulatory Board the authority to examine and modify these monopolies from time to time. We believe any modification must be in the public interest, must not undermine the Postal Service's ability to maintain universal service, and must protect the security and privacy of what is placed in the mailbox.

At the least, in the area of accountability, there should be standards drawing a clear line between what is appropriately a managerial function within the oversight of the Governors or Directors, what is a regulatory function committed to the regulator, and what is a public policy function reserved to the nation's lawmakers.

But accountability must be more than a function of external oversight. It must be a part of every activity within our organization, as well. And we are working to expand accountability throughout the Postal Service. Our new pay-for-performance system moves us further in this direction, directly linking compensation for management employees to their achievement of specific business goals. Individual performance indicators are aligned with customer service, revenue generation, cost management and enhancement of a performance-based culture.

To the President's list of five guiding principles for reform, I would add a sixth: a commitment to the collective-bargaining process. The Postal Service has been, and continues to be, a strong supporter of collective bargaining. Long-term financial and operational success, under any model, will require its continuation. This process of give and take assures that the interests of our employees – and the unions that represent them – are considered within the larger picture of the Postal Service's financial situation and the needs of our customers.

We agree with the Commission that the Postal Service, its employees and the unions that represent them would benefit by a more efficient collective-bargaining process. We also agree that addition of a mandatory mediation step – if negotiations have not resulted in a new agreement – could help forge a final resolution or limit the issues that must be addressed if interest arbitration becomes necessary.

As I mentioned, we have been very successful in cutting costs over the last four years. However, in some areas, structural issues – particularly as they reflect employee benefits – prevent similar success.

For example, in 2003 alone, benefit costs, including retirement contributions, health benefits, retiree health benefits and workers' compensation represented more than $13 billion – some 20 percent of our operating expenses. These costs continue to increase year to year at rates beyond normal inflation. While the Postal Service does negotiate the employer share of health benefit premium payments with its unions, the actual premium costs and the benefits offered by the plan are established by the Office of Personnel Management. Similarly, the workers' compensation program available to our employees was established by statute and is administered by OPM.

Workers' compensation represents a sizeable portion of our compensation and benefit costs. In fiscal year 2003, $1.5 billion in workers' compensation costs accounted for 2.9 percent of our total $50.5 billion in compensation and benefit costs. At the end of 2003, total liability for future workers' compensation costs was $7.1 billion. In addition to the $1.5 billion expense in 2003, an additional $704 million was paid in compensation and benefit costs for employees with work-related injuries in either limited duty or rehabilitation positions. And, despite growth in workers' compensation costs, our on-the-job illness and injury rates have been declining.

These amounts do not include the liability for Post Office Department compensation claims incurred before postal reorganization. Under the Postal Reorganization Act of 1971, the U.S. Government remained responsible for payment of all Post Office Department workers' compensation claims incurred before July 1, 1971. However, under the Balanced Budget Act of 1997, the remaining liability for these claim costs, estimated at $258 million, was recorded as an expense by the Postal Service. The liability for these Post Office Department claims at the end of fiscal year 2003 was $122 million.

The magnitude of workers' compensation costs has been a concern since the early days of postal reorganization. Although these costs were moderate in the years immediately following reorganization, they grew significantly with the 1974 amendments to the Federal Employees Compensation Act. Among other changes, these amendments eliminated the reduction in the level of workers' compensation benefits at age 70 and changed the three-day waiting period before benefits could be paid. The waiting period was moved from three-days after the date of injury to three days after the end of the 45-day period of continuation of pay received from the Postal Service by an injured employee.

Employees who receive benefits through the Office of Workers' Compensation Programs receive either two-thirds or three-quarters of their basic salary, based on their dependent status. These payments are nontaxable. In many cases, these compensation payments can be as much as 25 percent more than what the employee would receive in comparable retirement payments through the Office of Personnel Management.

Comparing two individuals, each at age 55 with 30 years of service at the end of 1993, and each at level 5, one of the most common pay grades, we find a disturbing disparity. One selects optional retirement from the active workforce and the other continues to receive workers' compensation benefits. Over a ten-year period, the individual who chose not to retire, but to continue receiving workers' compensation benefits, receives $95,000 more than the employee who chose to retire. And, for the individual receiving workers' compensation benefits, an annuity based on a higher earnings history results in a higher survivor annuity. This disparity in payment actually serves as a disincentive to retire, driving up workers compensation costs for the Postal Service.

A recent audit by the Postal Service's Office of Inspector General found that more than 2,000 Postal Service employees age 65 or older are on OWCP's periodic rolls; of that number, 382 are 89 or older. More than 3,000 of our employees have been on the periodic rolls for at least 20 years; 81 of these employees for at least 40 years.

While the Postal Reorganization Act of 1970 requires the Postal Service to bargain with its unions, workers' compensation was specifically excluded.

The President's Commission recommends that collective-bargaining include the ability of the parties to negotiate for benefits as well as wages. We agree with this position and emphasize that it is not our intention to reduce the benefits already enjoyed by current and retired Postal Service employees. Benefit negotiations would affect only eligible employees entering the Postal Service following the conclusion of negotiations.

We disagree with the Commission in its recommendation that the proposed Postal Regulatory Board determine the range within which wages would be negotiated. Such authority could impede the ability of the parties to successfully negotiate agreements and should not be within the role of the regulator.

Since the advent of collective bargaining in the Postal Service in 1971, there have been voices from all sides on whether postal wages were or were not comparable with private-sector wages, as required by current law. The Commission has taken the position that the proposed Postal Regulatory Board should make a "comparability" determination that would presumably end that argument. We believe this is unwarranted. Comprehensive reform legislation that would allow the parties to negotiate wages, hours, conditions of employment, and all benefits would make the perceived need for such a determination unnecessary. The Postal Service and its unions must be permitted to engage in direct negotiations which balance the needs of all parties without imposing the results of any specific comparability determination.

Speaking to you today, I am reminded of the efforts in the late 1960s to define a new and better model for the postal system in the United States. At a hearing not unlike this one, one of my predecessors, Postmaster General Larry O'Brien was asked by Representative Tom Steed, Chairman of the House Appropriations Subcommittee:

> General, would this be a fair summary: that at the present time, as manager of the Post Office Department, you have no control over your work load, you have no control over the rates of revenue that you are able to bring in, you have no control over the pay rates of the employees that you employ, you have very little control over the conditions of the service of these employees, you have virtually no control, by the nature of it, of the physical facilities that you are forced to use, and you have only a limited control at best over the transportation facilities that you are compelled to use . . . This is a staggering amount of "no control" in terms of the duties you have to perform.

Postmaster General O'Brien agreed.

And, in reviewing the details of some of the Commission's recommendations, particularly those related to the Postal Regulatory Board, I feel somewhat like Larry O'Brien did. In return for some basic elements of rate-setting flexibility, the Postal Service is asked to cede a staggering amount of control in areas that – for both government and the private sector – are traditionally at the core of the decisions and responsibilities of management.

The mail is today – and will remain for many years to come – a critical element of our nation's infrastructure. We believe there is a proper balance between increased flexibility for the Postal Service and an effective level of independent oversight. In achieving that balance, we have the opportunity to create a legacy of customer-responsive service that serves everyone in our nation equally – and equally well.

I am encouraged by the interest of this Panel in holding a series of hearings to review the issue of legislative modernization within the perspective of the recommendations of both the President's Commission and the President's principles of reform. Through its actions of the past year, the administration has added a new voice to the important conversation about the future of America's mail system. It is not a conversation that can be limited to the Postal Service and its industry partners. It is a conversation that will result in broad public policy decisions that will affect every family, every business and every community in the nation. For that reason, the decisions that are made must be in the public interest and they must reflect the will of both the Congress and the Administration.

Earlier in my testimony, I mentioned the effect of Civil Service Retirement System reform legislation on the Postal Service's finances. While this law has provided benefits to the Postal Service and those it serves, it has also resulted in a number of challenges.

First, the legislation shifted the responsibility of funding CSRS retirement benefits earned by postal employees while they served in the military from the Treasury to the Postal Service. This transferred an obligation of more than $27 billion from taxpayers to postal ratepayers. Of this amount, $17 billion represents retroactive payments of funds (including imputed retroactive interest) already provided to annuitants by the Treasury between 1971 and 2002. In most cases, these costs continue to be paid through general appropriations. The Postal Service does not receive general appropriations: our operations are funded by the revenue generated by the sale of postal products and services. These military retirement costs have no connection to the operation of the Postal Service or to the services rendered to our customers now and in the future. In fact, more than 90 percent of that financial obligation is the result of military service performed before the Postal Service was created. It includes service in World War II, Korea and Vietnam.

The President's Commission recommends that military service costs not be borne by the Postal Service. We agree with the Commission on this issue, as we indicated in the report which we provided in compliance with your requirement in the reform legislation. While, in their recent review of this issue, the General Accounting Office and the Office of Personnel Management suggest that it might be reasonable to argue that the Postal Service should be responsible for these costs, because it hires an employee knowing of past military service, we disagree with their reasoning and position as being counter to public law and policy, since military service has no direct bearing on postal operations and all taxpayers benefit from military service.

The CSRS payment reform legislation also asked the Postal Service for its proposals regarding the use of the "savings" resulting from the act, beginning in 2006. Those "savings" would be placed in an escrow account pending Congressional authorization about how they would be used.

I would like to take a moment to explain these "savings." They represent the difference between the Postal Service's new CSRS payment schedule and the old. They represent an adjustment of payments, costs we will not have to pay in the future. But simply because we will not be liable for these costs in the future, does not mean that there will be a reserve of actual cash waiting to be diverted to other purposes. Rather than building cash, the "savings" are used to fund normal inflationary cost increases such as Cost-of-Living Allowances and general pay adjustments required by collective bargaining agreements, increased health care benefit expenses for employees and annuitants, and growth in non-personnel expenses for fuel, utilities and materials.

For the period from 2003 through 2005, there are actual funds available – savings – to use for other purposes. This is because the postage rates now in effect were computed based on our former, higher CSRS payment schedule. A percentage of the price of every postage stamp has been earmarked for those payments. And, as the law requires, today's savings are contributing to debt reduction, both last year and this year, and to hold postage rates steady through 2005.

But by 2006, inflationary cost increases will have whittled away the financial benefit of lower CSRS payments. Even without the escrow requirement, we expect that we will have to raise rates in 2006. With the escrow requirement, postage rates will have to rise even more than is necessary to reflect inflation – some have suggested that the increase would be in the double digits. This is because the new rates would have to generate the revenue to cover what is being called the "savings," the difference between the old and new CSRS funding schedule.

With a continuing, future, escrow-funding requirement, we would have to continually and frequently increase rates simply to fund the escrow account. As I mentioned, this “hands-off” fund could be spent by the Postal Service only with Congressional authorization. Thus, without further legislation, the benefits enjoyed by every mail user in the nation – business, nonprofit and consumer – would evaporate as early as 2006 through the higher rates required to fund the escrow account. This would put postal customers back where they started before the legislation was enacted – reinstating the very over-funding the legislation was designed to correct.

We propose that the escrow account be eliminated. We have also offered two alternative proposals.

First, if the $27 billion CSRS military funding requirement is transferred back to the Treasury, the Postal Service would have fully funded and, in fact, over-funded its CSRS payment obligation by $10 billion. We would then be in a financial position to pre-fund retiree health benefit obligations on a current basis for all employees and retirees. This is our preferred alternative.

Our second proposal is based on the CSRS military funding requirement remaining an obligation of the Postal Service. If that is the case, the Postal Service proposes that the savings from the account be used to begin pre-funding post-retirement health benefit costs for newly hired Postal Service employees.

We are pleased that the General Accounting Office found that both of our proposals were consistent with the CSRS funding reform law.

The Postal Service’s preferred proposal responds to the Sense of Congress regarding the appropriate use of “savings” under the Act and re-directs nearly all Postal Service over funding of CSRS to pre-fund retiree health benefits. As disclosed in our 2003 Annual Report, we estimate the value of this long-term obligation as being between $47 and $57 billion as of the end of FY 2003. Under this preferred proposal, we estimate that in 2006 alone, at the inception of the proposed plan, we would contribute $5.0 billion to the Postal Service retiree health benefit fund. This amount is $1.2 billion greater than the CSRS and retiree health benefit funding we would provide under current laws. I should point out that the USPS is the only federal agency that pays directly for retiree health benefit costs.

This preferred proposal uses Postal Service funds for recognized Postal Service obligations, the legitimate business purpose for which these funds were collected from postal ratepayers over the last 32 years. In pre-funding retiree health benefits as we propose, the Postal Service will reduce the pressure on rates, lessen the burden on future postal ratepayers, and help strengthen the long-term promise of providing universal mail service to the American public.

In connection with the escrow provision, and at the request of Special Panel Chairman McHugh, Committee Chairman Davis and Committee members Henry Waxman and Danny Davis, we will be providing additional information about how our Five-Year Capital Plan ties both to our Strategic Plan and Transformation Plan. Through our Five Year Strategic Plan – which fully complies with the Government Performance and Results Act – and our recent Transformation Plan Progress Report, we have reported to Congress on our plans and the state of our progress.

We believe, however, that using the escrow requirement as an additional oversight mechanism simply is not necessary and, further, will force the Postal Service to raise rates to generate billions of dollars in revenues over which we can exercise little control. We believe that our preferred proposal, under which military pension costs are the responsibility of the Department of the Treasury, and the Postal Service prefunds retiree health benefits, is in the best interests of the American taxpayers as well as all postal stakeholders. As the GAO has recognized, this proposal achieves a fair balance between current and future ratepayers while allowing the Postal Service to prefund a greater portion of its long-term obligations.

At this point, I should mention that, as provided for in the Pension Reform Act, the Postal Service has filed an appeal with the Board of Actuaries of the CSRS pertaining to the methodology OPM used in determining Postal Service CSRS obligations. The allocation method proposed by OPM burdens the Postal Service with an inequitable allocation of CSRS costs. We proposed an alternative method that we regard as more equitable and consistent with allocation methodologies previously used by OPM.

Accordingly, we have asked the Board of Actuaries to reconsider, review and make adjustment to the methodology and determinations made by OPM in this matter. With the refinement we have proposed, the Postal Service could immediately fund its full current obligation for retiree health benefits and pre fund remaining retiree health care costs on a current basis as recommended by the GAO.

Mr. Chairman, I have been asked for my vision of the Postal Service. We need a Postal Service that has the incentives necessary to improve service and productivity. We need a Postal Service that is given the flexibility to reduce costs. We need a Postal Service that has the ability to implement rates that are responsive to the market and that will mitigate large rate increases that have become counterproductive.

We need a Postal Service that has the ability to work with and treat customers as individuals with individual needs. We need a Postal Service where our products, services and systems are available to those we serve where they are located, not just where there are Post Offices. Finally – and importantly – we need to retain a motivated and informed workforce to provide universal service to every home and business in the nation.

I look forward to working with this Panel and others in Congress to identify the business model that will enable the Postal Service to serve everyone in America, today and far into the future.

I pledge to provide the cooperation, the resources and the support that will enable us to do that. We cannot afford to do otherwise.

Thank you. I will be happy to answer any questions you may have.

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