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Comptroller General
of the United States

United States General Accounting Office
Washington, DC 20548

February 6, 2004

The Honorable Susan M. Collins
Chairman, Committee on
Governmental Affairs
United States Senate

Subject: *Need for Comprehensive Postal Reform*

Dear Chairman Collins:

This letter responds to your request for our views on the need for postal reform and is based upon our prior testimonies related to this issue.¹ In summary, we believe that comprehensive postal reform is urgently needed. The ability of the Service to remain financially viable is at risk because its current business model—which relies on mail volume growth to cover the costs of its expanding delivery network—is not well aligned with 21st century realities. Since we placed the Postal Service’s transformation efforts and financial outlook on our High-Risk List in April 2001, I have testified on several occasions about the governance, financial, operational, and human capital challenges that threaten the Service’s ability to carry out its mission. If not effectively addressed in a timely manner, these challenges serve to threaten the Service’s ability to remain self-supporting while providing affordable, high-quality, and universal postal services to all Americans.

The following key trends serve to reinforce our view that enactment of postal reform legislation is needed:

- *Declining mail volume:* Total mail volume declined in fiscal year 2003 for the third year in a row—a historical first for the Service, which has depended on rising mail volume to help cover rising costs and mitigate rate increases. First-Class Mail volume declined by a record 3.2 percent in fiscal year 2003 and is projected to decline annually for the foreseeable future. Some of this decline is due to technology advances (e.g. E-mail, digital phones, faxes, and electronic bill payments) that are likely to increase in the future. This trend is particularly significant because First-Class Mail covers more than two-thirds of the Service’s institutional costs.

¹ See U.S. General Accounting Office, *U.S. Postal Service: Bold Action Needed to Continue Progress on Postal Transformation*, [GAO-04-108T](#) (Washington, D.C.: Nov. 5, 2003); and *U.S. Postal Service: Key Elements of Comprehensive Postal Reform*, [GAO-04-397T](#) (Washington, D.C.: Jan.28, 2004).

- *Changes in the mail mix:* The Service's mail mix is changing with declining volume for high-margin products, such as First-Class Mail, and increasing volume of lower-margin products, such as some types of Standard Mail. These changes reduce revenues available to cover the Service's institutional costs.
- *Increased competition from private delivery companies:* Private delivery companies dominate the market for parcels greater than 2 pounds and appear to be making inroads into the market for small parcels. Priority Mail volume fell 13.9 percent in fiscal year 2003 and over the last 3 years has declined nearly 30 percent. Once a highly profitable growth product for the Service, Priority Mail volume is declining as the highly competitive parcel market turns to lower-priced ground shipment alternatives. Express Mail volume is declining for the same reason. In addition, United Parcel Service (UPS) and FedEx have established national retail networks through UPS's acquisition of MailBoxes Etc., now called UPS Stores, and FedEx's recent acquisition of Kinko's.
- *Subpar revenue growth:* The Service's revenues are budgeted for zero growth in fiscal year 2004, which would be the first year since postal reorganization that postal revenues have failed to increase. However, as the Service has recognized, even the zero-growth target will be challenging. In the absence of revenue growth generated by increasing volume, the Service must rely more heavily on rate increases to cover rising costs and help finance capital investment needs.
- *Declining capital investment:* The Service's capital cash outlays declined from \$3.3 billion in fiscal year 2000 to \$1.3 billion in fiscal year 2003, which was the lowest level since fiscal year 1986, and far below the level of the late 1990s, when the Service spent more than \$3 billion annually. Capital cash outlays are budgeted to increase to \$2.4 billion in fiscal year 2004, but this level may not be sufficient to enable the Service to fully fund its capital investment needs. In the longer term, it is unclear what the Service's needs will be to maintain and modernize its physical infrastructure, as well as how these needs will be funded.
- *Renewed difficulties in substantially improving postal productivity:* The Service's productivity increased by 1.8 percent in fiscal year 2003 but is estimated to increase by only 0.4 percent in fiscal year 2004. In the absence of mail volume growth, substantial productivity increases will be required to help cover cost increases generated by rising wages and benefit costs and to mitigate rate increases.
- *Significant financial liabilities and obligations:* Despite the passage of legislation that reduced the Service's pension obligations, the Service has about \$88 billion to \$98 billion in liabilities and obligations that include \$47 billion to \$57 billion in unfunded retiree health benefits. Under the current pay-as-you-go system, the Service may have difficulty financing its retiree health benefits obligation in the future if mail volume trends continue to impact revenues while costs in this area continue to rise. The Service has recently proposed two options to Congress, so the Service could prefund this obligation to the extent that it is financially able.

- *Uncertain funding for emergency preparedness:* The Service requested \$350 million for emergency preparedness for fiscal year 2004, which it did not receive, and \$779 million for fiscal year 2005. If the money is not appropriated, funding for this purpose may have to be built into postal rates.
- *Challenges to achieve sufficient cost cutting:* The Service achieved additional cost cutting to compensate for below-budget revenues in fiscal year 2003. Despite this progress, in the longer term it is unclear whether continued cost-cutting efforts can offset declines in First-Class Mail volume without impacting the quality of service.

Although we have discussed numerous actions that the Postal Service can take within its existing authority to improve its overall efficiency and effectiveness, we do not believe that incremental steps toward postal transformation can resolve the fundamental and systemic issues associated with the Service's current business model. To avoid the risk of a significant taxpayer bailout or dramatic postal rate increases, we believe that Congress should enact comprehensive postal reform legislation that includes the Service's overall statutory framework, resolution of issues regarding the Service's pension and retiree health benefits obligations, and whether there is a continued need for an escrow account.

The key areas of the Service's statutory framework that need to be addressed include:

- *clarifying the Service's mission and role* by defining the scope of universal service and the postal monopoly and by clarifying the role of the Service in regard to competition and its regulatory functions;
- *enhancing governance, transparency, and accountability* by delineating public policy, operational, and regulatory responsibilities; by ensuring managerial accountability through a strong, well-qualified corporate-style board that holds its officers responsible and accountable for achieving real results; and by defining appropriate reporting mechanisms to enhance the Service's transparency and accountability for financial and performance results;
- *improving flexibilities and oversight* by balancing increased flexibility for the Service— through streamlining the rate-setting process and allowing a certain amount of retained earnings—with appropriate oversight by an independent regulatory body to protect postal customers against undue discrimination, to restrict cross-subsidies, and to ensure due process. In addition, the Service needs additional flexibility to rationalize its infrastructure and reshape its workforce. Any such additional flexibility should be accompanied by appropriate safeguards to prevent abuse along with enhanced transparency and accountability mechanisms; and
- *making needed human capital reforms* such as (1) determining the Service's responsibility for pension costs related to military service, funding retiree health benefits, and determining what action to take on the escrow account established in recent pension legislation; (2) deciding whether postal workers' compensation

benefits should be on par with those in the private sector; and (3) clarifying pay comparability standards.

We believe that Congress now has a rare opportunity to assure the Service's long-term financial viability through comprehensive postal reform legislation that addresses the Service's key structural and systemic deficiencies, its unfunded obligations, including its retiree health benefits obligation, and the escrow requirement. Key legislative and administrative actions in connection with transforming the Postal Service can also serve as positive examples for other key government transformation efforts.

As agreed with your office, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the date of this letter. At that time, we will provide copies to interested congressional committees. We will also make copies available to others on request. In addition, the report will be available at no charge on the GAO Web site at <http://www.gao.gov>.

For additional information about this report, please contact Mark L. Goldstein, Director, Physical Infrastructure Issues at (202) 512-2834 or at goldsteinm@gao.gov. Please contact me if I can be of any further assistance to help make comprehensive postal reform a reality.

Sincerely yours,

A handwritten signature in black ink, appearing to read "D. M. Walker", with a long horizontal line extending to the right.

David M. Walker
Comptroller General
of the United States

(543095)

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