February 2002

U.S. POSTAL SERVICE

Deteriorating Financial Outlook Increases Need for Transformation

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Abbreviations

APWU  American Postal Workers Union
COLA  cost-of-living adjustment
DPMG  deputy postmaster general
OPM   Office of Personnel Management
PMG   postmaster general
PRC   Postal Rate Commission
PYLR  Prior Years' Losses Recovery
USPS  U.S. Postal Service
February 28, 2002

The Honorable Joseph I. Lieberman  
Chairman  
The Honorable Fred Thompson  
Ranking Minority Member  
Committee on Governmental Affairs  
United States Senate

The Honorable Daniel K. Akaka  
Chairman  
The Honorable Thad Cochran  
Ranking Minority Member  
Subcommittee on International Security,  
    Proliferation, and Federal Services  
Committee on Governmental Affairs  
United States Senate

This report responds to your request in March 2001 that we assess the financial condition of the U.S. Postal Service (USPS) and its long-term outlook as well as the financial, operational, and structural issues that may affect USPS's ability to carry out its mission. The committee and subcommittee expressed concern about the deteriorating financial situation of USPS and requested our review to help improve the understanding of USPS's current financial situation; the causes of the anticipated financial deficits; and the implications in the short term and long term on USPS's financial condition, operations, and customers. Accordingly, the specific objectives of our review were to (1) assess USPS's fiscal year 2001 financial results and its long-term outlook; (2) discuss the legal requirements and practical constraints that need to be addressed as well as selected options to be considered for USPS to achieve a successful transformation to overcome its financial, operational, and human capital challenges; and (3) discuss information on actions USPS has taken to implement recommendations we made to it in April 2001 related to its financial situation.¹

In April 2001, we placed USPS's transformation efforts and long-term outlook on our High-Risk list, noting that USPS is at growing risk of not being able to continue its mission of providing the current level of universal postal service throughout the nation while maintaining reasonable rates and remaining largely self-supporting through postal revenues. We included USPS on our High-Risk list to focus attention on the dilemmas facing USPS before the situation escalates into a crisis in which the options for action may be more limited and costly. We recommended that the following actions be taken:

- USPS should develop a comprehensive transformation plan—in conjunction with Congress and other stakeholders, such as the postal unions and management associations, customers, and the Postal Rate Commission (PRC)—that would identify the actions needed to address USPS's financial, operational, and human capital challenges and establish a time frame and specify key milestones for achieving positive results.

- USPS should provide summary financial reports to Congress and the public on a quarterly basis. These reports should provide sufficiently detailed information for stakeholders to understand USPS's current and projected financial condition, how its outlook may have changed since the previous quarter, and its progress toward achieving the desired results specified in its comprehensive plan.

In May 2001, we testified before this committee and subcommittee on USPS's financial outlook and transformation challenges that needed to be addressed. At that time, USPS's net income had declined over the past 5 years, its outstanding debt had increased at the end of each fiscal year since 1997, and it expected electronic diversion to cause substantial declines in First-Class Mail volume in the next decade. We stated that USPS faced major challenges that called for prompt, aggressive action, particularly in the areas of cutting costs and improving productivity in the near term. Further, we noted that Congress must revisit the statutory framework under which USPS operates and take actions to deal with the systemic problems facing USPS that call for a transformation if USPS is to remain viable in the 21st century.

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Our assessment of USPS's financial condition and transformation challenges for this report is based on our previous work; updated financial data, projections, and other information that USPS provided to us; interviews with USPS officials, including its chief financial officer; and interviews with other stakeholders. This report discusses the actual financial results for fiscal year 2001 as compared with USPS's budget approved by its Board of Governors in November 2000 and USPS's current financial outlook. USPS's financial situation is complex, and we could not assess, within our available time and resource constraints, the validity of all of the data and assumptions that support USPS's financial projections. One area that may have an impact on USPS's financial situation is its response to the terrorist and anthrax incidents that occurred in the fall of 2001. Accordingly, in preparing this report, we also used the results of a 1-day conference we hosted in December 2001 at the request of the chairman and ranking minority member of the House Committee on Government Reform. The conference participants discussed bioterrorism threats, options for USPS and the mailing industry for improving security, and issues and options relating to improving postal operations.

We conducted our review at USPS headquarters in Washington, D.C., from March 2001 through February 2002 in accordance with generally accepted government auditing standards. We requested comments on a draft of this report from USPS, and its comments are discussed later in this report and reproduced in appendix II.

Results in Brief

USPS's financial outlook is becoming increasingly dire. USPS has continuing deficits, severe cash-flow pressures, rising debt, and liabilities that exceed its assets. USPS also lacks sufficient income to fund growing capital asset needs for safety, maintenance, expansion, and modernization as well as to fund its liabilities. In fiscal year 2001, USPS reported a $1.68 billion deficit, up from a $199 million deficit in the preceding fiscal year. Further, USPS budgeted for a $1.35 billion deficit in fiscal year 2002, before the catastrophic events of September 11 and subsequent use of the mail to transmit anthrax. The combined effect of these events and the current economic slowdown have served to further exacerbate USPS's financial difficulties by decreasing postal revenues, while postal costs continued to increase despite additional USPS cost-cutting efforts. USPS's mail volumes

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are beginning to decline in its major revenue producing areas, and despite recent rate increases, its costs are increasing faster than its revenues. USPS has requested an above-inflation rate increase that is expected to take effect later this year. In the short term, USPS may have to rely primarily on cutting costs and raising rates. However, raising rates may cause mail volumes to decrease and encourage mailers to shift more mail to electronic and other delivery alternatives. In the long term, pressures to increase rates will continue as USPS will need increasing amounts of funds to pay its growing long-term obligations, which include employee retirement and health benefits. Thus, USPS's ability to continue to fulfill its mission by providing the current level of universal postal services at reasonable rates on a self-supporting basis is increasingly at risk.

USPS's basic business model, which assumes that rising mail volume will cover rising costs and mitigate rate increases, is increasingly problematic since mail volume could stagnate or decline further. USPS has also had difficulty in making and sustaining productivity increases. Moreover, USPS's framework of legal requirements, which form the foundation of USPS's business model, as well as practical constraints impede USPS's ability to ensure its own financial viability. For example, USPS's statutory framework, which includes a monopoly on letter mail, a break-even mandate, and a cost-based rate-setting structure, provides limited incentives to cut or restrain costs or to be innovative. Furthermore, USPS faces structural, legal, and practical constraints related to its infrastructure, including closing or consolidating postal facilities and realigning its workforce as its operations change. Other structural issues have been raised, such as USPS's governance structure—for example, what type of governing board is appropriate for USPS, given the complex mission and role of this $70 billion entity with nearly 900,000 employees. If USPS's financial and structural problems are not resolved, this could result in additional significant rate increases, lower quality of service, and/or the need for additional federal appropriations. USPS could do more under its current authority to lower costs and increase productivity. A range of options to improve postal operations includes replicating best practices across mail-processing plants, better aligning the workforce with operational needs, and redesigning the mail classification system and rate structure for more cost-efficient mail preparation. However, efforts to improve efficiency will probably not be enough to alleviate growing financial pressures, in part because of continuing difficulties in significantly reducing costs, particularly in the areas relating to USPS's infrastructure and workforce.
USPS's worsening financial situation and outlook intensify the need for a comprehensive transformation that will address its financial, operational, and human capital challenges as well as the provision by USPS of more timely and accessible financial information. USPS has begun to implement our previous recommendations to develop a transformation plan and improve its financial information. In the fall of 2001, USPS published a discussion outline of concepts for postal transformation and called for public comments on transformation issues. USPS is working to develop and finalize its transformation plan by March 31, 2002. In addition, although USPS has made more financial data available on its Web site, it has not made some key financial data publicly available in as timely a manner as we believe is necessary to improve transparency.

Congress has considered but not enacted various legislative postal reform proposals over the last 7 years. These reform proposals addressed many key transformation issues but did not fully address constraints related to USPS's infrastructure and workforce. Also, consensus among postal stakeholders has been difficult to achieve. Thus, strong leadership—starting with USPS—will be critical to achieving the necessary consensus for change between Congress and the divided stakeholder community. Further, action by Congress on comprehensive reform legislation will be critical to sustain USPS's financial viability. Accordingly, we are recommending in this report that:

- USPS's Board of Governors and postmaster general (PMG) provide proactive leadership for transformation by informing its employees, Congress, stakeholders, and the public about the need for change and by identifying in its forthcoming transformation plan (1) actions that USPS can take within its current authority, (2) specific congressional actions that would enable USPS to take a number of incremental steps to address its growing financial and operational challenges, and (3) a process to address a range of comprehensive legislative reforms that will be needed to address key unresolved transformation issues;

- USPS improve the transparency of its financial data by posting monthly and quarterly financial reports on its Web site in a more timely manner;

- Congress consider and promptly act on incremental legislative changes that would provide USPS with some additional flexibilities while incorporating appropriate safeguards to prevent abuse. In addition, comprehensive legislative changes will be needed to address key unresolved transformation issues. Congress could also consider how
best to address issues, such as infrastructure and workforce issues, that may require input from a variety of stakeholders and will involve some shared sacrifice. One option could be to create a commission to address unresolved transformation issues and develop a comprehensive proposal for consideration by Congress.

In commenting on a draft of our report, the PMG agreed with our recommendations and said that USPS plans to inform Congress and the public of the need for change in its transformation plan and by other means. In addition, he stated that USPS intends to work with Congress and all stakeholders in developing and implementing strategies for action. He also agreed with our recommendation to improve the transparency of USPS’s financial data.

Background

USPS is the single largest federal civilian agency, with a mission vital to the nation’s communication and commerce. Compared with private U.S. companies, USPS is the second largest employer with its nearly 900,000 full-time and part-time employees. Four major unions represent the interest of bargaining unit employees; and three management associations represent USPS supervisors, postmasters, and other managerial, nonbargaining personnel. USPS currently maintains a massive infrastructure, developed incrementally over many years, consisting of more than 38,000 post offices, branches, and stations and 350 major mail-processing and distribution facilities. USPS is the focal point of a $900 billion mailing industry that employs 9 million people and accounts for 8 percent of the U.S. gross domestic product, according to a recent report.4

The Postal Reorganization Act of 1970 (P.L. 91-375) reorganized the former U.S. Post Office Department into the U.S. Postal Service, an independent establishment of the executive branch with a mandate to provide prompt, reliable, and efficient mail services to all areas of the country. USPS is intended to be self-supporting from postal operations and is mandated to break even over time. To change domestic postal rates, USPS must first obtain a prior review from the independent PRC before it can finalize new rates. In general, the complex process for USPS to change rates can take about 18 months—4 to 6 months for USPS to prepare its filing for a rate case, up to 10 months for the PRC to review proposed rate increases and

make its recommended decision, and about 2 months or longer for USPS to make its final decisions and implement the new rates.

USPS has an 11-member Board of Governors, which is responsible for directing the organization. Board members include (1) nine presidential appointees who serve on a part-time basis with 9-year staggered terms; (2) the PMG, who is appointed by the governors; and (3) the deputy postmaster general (DPMG), who is appointed by the governors and the PMG. The nine presidential appointees are chosen to represent the public interest generally, cannot be representatives of specific interests, are subject to Senate confirmation, and may be removed only for cause. No more than five of these appointees may belong to the same political party. No other qualifications or restrictions are specified in law.

USPS's Deteriorating Financial Results and Outlook

Overall, USPS's financial condition has continued to deteriorate. Although USPS is mandated to break even over time, it is not generating sufficient revenues to cover both its operating expenses and capital needs, which continue to grow. From fiscal year 1995 to fiscal year 2001, USPS's net income has continually declined (see fig. 1). Further, since fiscal year 2000, USPS has been incurring net losses, and losses are projected for fiscal year 2002. Since its inception, USPS has accumulated losses from deficits in prior years, and its debt balance with the U.S. Treasury continues to grow. At the end of fiscal year 2001, USPS's mail volumes declined for the second time in 25 years and expense growth continued to outpace USPS's revenue growth. Following the terrorist and anthrax incidents in the fall of 2001, USPS has experienced lower mail volumes and revenues than expected and may incur higher expenses for safety and security. Historically, USPS has had difficulty cutting costs related to its large workforce and infrastructure. The continuing recession and recent terrorist incidents have negatively affected USPS's mail volumes; and despite USPS's cost-cutting efforts, revenues decreased while costs continued to rise, thus decreasing net income. USPS's dire financial situation, coupled with increased competition and the availability of alternatives to the mail, threatens the viability of USPS's basic business model for the 21st century.

5 According to its bylaws, the board directs the exercise of the powers of USPS, reviews its practices and policies, and directs and controls its expenditures. The board is to monitor the operations and performance of USPS and establish USPS's basic objectives, broad policies, and long-range goals. See 39 C.F.R. 3.1.
Figure 1: Net Income/Losses of USPS from Fiscal Years 1972 to 2002

Source: USPS financial data.

USPS reported a deficit of $1.68 billion for fiscal year 2001 and has budgeted a deficit of $1.35 billion for fiscal year 2002. However, this budget estimate was forecast before the occurrence of the September 11 terrorist attacks and anthrax incidents. In the first postal quarter of fiscal year 2002, mail volumes were 4.9 percent below estimates that were included in USPS's approved budget, and revenues were $876 million less than budgeted; costs were held to $355 million below budget. This resulted in net income being $521 million less than planned. However, USPS’s deficit

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6 USPS uses a “postal fiscal year” for management purposes that contains 52 weeks. USPS divides each postal fiscal year into 13 accounting periods of 4 weeks each. The first postal quarter corresponds to the first 3 accounting periods of the postal fiscal year. All references in this report to results for the first quarter of postal fiscal year 2002 are for the period from September 8, 2001, through November 30, 2001.
for fiscal year 2002 could be mitigated by the expected settlement and implementation of its pending request for a rate increase.

Continuing deficits have resulted in insufficient cash to finance capital project needs and repay debt. In addition, USPS's debt continues to grow and is nearing its $15 billion statutory limit.¹ USPS's debt is budgeted to reach $12.9 billion by the end of fiscal year 2002. Currently, USPS's liabilities exceed its assets. USPS's substantial and growing liabilities will require increasing amounts of funds in the future.

USPS's financial outlook is likely to continue deteriorating unless it can find ways to stimulate revenue growth and significantly cut costs. Even if USPS raises rates and achieves positive net income in a given year, that will not resolve its fundamental financial problems, including those relating to declining mail volumes, because rate increases are likely to encourage the shift of more mail to electronic and other alternatives. Some costs, notably for pensions and retiree health benefits, are difficult to control and are expected to increase substantially in the coming decade.² Similarly, USPS delivery costs increase annually, that is, nearly 2 million new delivery points were added last year. To improve its financial outlook, USPS needs to concentrate its current efforts on cutting costs, improving productivity, and adding value to the mail as well as overhauling its basic business model, as described in the final section of this report.

The following table summarizes the key aspects of USPS's declining financial outlook. A further discussion of fiscal year 2001 results is included in appendix 1.

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¹ USPS also has a $3 billion statutory limit on the annual increase in its outstanding obligations, including $2 billion for capital investment and $1 billion for other operating expenses. See 39 U.S.C. § 2005(a).

<table>
<thead>
<tr>
<th>Area</th>
<th>Results in fiscal year 2001</th>
<th>Outlook for fiscal year 2002</th>
</tr>
</thead>
</table>
| Net income                | • Net loss of $1.68 billion, despite rate increases during the year averaging about 6 percent. First-Class stamp rate rose by 1 cent to 34 cents.  
• Mail volumes fell 0.2 percent and revenues fell below expectations mainly due to a slowing economy.  
• Expenses rose twice as fast as revenues but were slightly less than budgeted. | • USPS will be challenged to hold its net deficit to the $1.35 billion amount budgeted.  
• In the first quarter, mail volumes were 4.9 percent below budget, and revenues were $876 million below budget.  
• USPS has requested a rate increase averaging 8.7 percent. Rates are expected to increase this summer, with the First-Class stamp rate rising by 3 cents.  
• Large cost reductions are planned, but uncertainty remains regarding security- and safety-related costs.  
• Expenses are increasing faster than revenues despite cost-cutting efforts. |
| Cash flow                 | • Positive cash flow from operations was $1.3 billion.  
• Insufficient cash flow precipitated cuts in capital programs and resulted in additional borrowing. | • Continued cash flow pressures due to continuing losses. |
| Capital program           | • Freeze on capital commitments was implemented for most facility projects.  
• Capital commitment for new projects was $1 billion, down from over $3 billion annually in the 5 previous years.  
• Capital outlays were $2.9 billion, $700 million less than budgeted. | • Freeze on capital commitments has been extended.  
• Capital commitment is budgeted at $2.4 billion and outlays at $2.2 billion. However, sufficient cash may not be available to fund this level of capital commitments. |
| Net position              | • Liabilities exceeded assets by $2.3 billion.* | • Negative net position is expected to worsen. |
| Liabilities for pensions  | • Pension liabilities were $32 billion, plus an anticipated $15.8 billion for future interest charges over a 30-year period.*  
• Workers' compensation liabilities were $6.0 billion. | • Pension and workers' compensation liabilities are expected to grow. |
| and workers' compensation |                                                                                             |                                                                                               |
| Debt                      | • Debt increased by $2 billion to $11.3 billion, a new record.  
• No debt reduction plan. | • Current net income projections do not provide the capacity for debt reduction. USPS budgeted a $1.6 billion increase in total debt.  
• The budgeted increase would bring debt to $12.9 billion, or $2.1 billion under its $15 billion limit. |
| Accumulated prior-years'  | • Prior years' losses since fiscal year 1971 reached $5.4 billion. | • Prior years' losses are budgeted to increase to $6.6 billion. |
| losses                    |                                                                                             |                                                                                               |

*Net liability of $2.3 billion includes a $32 billion deferred retirement asset, which is an intangible asset that is not an economic resource that can be applied to cover USPS's liabilities.

*USPS also has an unrecorded obligation for retiree health benefit premiums that it must pay under provisions of the Omnibus Budget Reconciliation Act of 1990 (P.L. 101-508), as discussed later in this report.

Sources: USPS data and GAO analysis.

In fiscal year 2001, overall mail volume fell 0.2 percent, which was only the second annual decline since fiscal year 1975. Growth in mail volumes for
USPS's largest revenue source, First-Class Mail, has slowed in recent years (see fig. 2). In fiscal year 2001, First-Class Mail volume grew only 0.1 percent, which was the smallest growth rate in the last 25 years. First-Class Mail is a particularly important category of mail because it generated 54 percent of USPS revenues and covered two-thirds of institutional expenses in fiscal year 2000. Additionally, Standard Mail volumes—that is, primarily advertising mail—which account for most of the remaining revenues, decreased by 0.1 percent in fiscal year 2001, the first decline in 10 years. In contrast, Standard Mail volume on average had grown nearly 5.0 percent in the previous 5 years. USPS officials attribute the changes in mail volumes primarily to the slowing economy and also to the diversion by mailers of First-Class Mail, and to a lesser degree, Standard Mail, to the Internet.
Recent declines in mail volume growth are depressing revenues at a time when expenses are growing and cash flow is needed to fund capital expenditures and debt repayment. Since fiscal year 1996, operating expenses have grown faster than operating revenues and grew 4.2 percent in fiscal year 2001, which was twice as fast as the 2.0-percent growth in operating revenue (see fig. 3).
Declining Net Income

USPS's poor financial outlook for fiscal year 2002 has been exacerbated by the continuing recession and terrorist incidents. Mail volume and revenues declined after September 11, while costs continued to rise, despite cost-cutting efforts. As shown in table 2, during the first quarter of fiscal year 2002, mail revenue was 5.4 percent below budget. This shortfall resulted in $876 million revenue less than budgeted, while expenses were $355 million under budget. USPS achieved a net income of only $108 million, which was $521 million less than budgeted. Typically, the first quarter is USPS's most profitable of the fiscal year. USPS will be challenged to meet its net income targets for the remainder of the year. Uncertainties surrounding USPS's net income targets include future mail volumes, the extent to which USPS can cut costs, and the potential for other added costs.
Table 2: Quarter 1, Fiscal Year 2002 Budgeted Versus Actual Results

<table>
<thead>
<tr>
<th></th>
<th>Budgeted</th>
<th>Actual</th>
<th>Variance of actual from budgeted</th>
<th>Percentage variance</th>
<th>Percentage change from same period last year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>$16,243</td>
<td>$15,367</td>
<td>$(876)</td>
<td>(5.4%)</td>
<td>(0.5%)</td>
</tr>
<tr>
<td>Expense</td>
<td>$15,614</td>
<td>$15,259</td>
<td>$(355)</td>
<td>(2.3%)</td>
<td>0.4</td>
</tr>
<tr>
<td>Net Income</td>
<td>$629</td>
<td>$108</td>
<td>$(521)</td>
<td>(82.8%)</td>
<td>(56.3%)</td>
</tr>
<tr>
<td>Mail volumes</td>
<td>51,029</td>
<td>48,551</td>
<td>(2,491)</td>
<td>(4.9%)</td>
<td>(5.5%)</td>
</tr>
</tbody>
</table>

Note: Negative numbers are in parentheses.
Source: USPS financial and mail volume data.

Growing Expenses

In its fiscal year 2002 budget, USPS projected that its expenses would increase 3.2 percent. Budgeted expense increases included increases in salaries and benefits, pensions, retiree health care, and workers' compensation, among other items. To help offset these expense increases, USPS's budget called for reductions of 13,000 work years, or a 1.9-percent reduction, to be achieved in part by reducing the number of employees in field operations.

Compensation and benefits covering personnel-related expenses, including interest expenses on deferred retirement liabilities, totaled approximately $53 billion, or about 78 percent of the total expenses in fiscal year 2001. A key component, USPS's retirement-related expenses, have grown as a percentage of total expenses from 3.9 percent in fiscal year 1972 to 14.4 percent in fiscal year 2001. Budgeted retirement-related expenses for fiscal year 2002 are $10.3 billion, including an interest expense of $1.6 billion.

USPS's expenses for the remainder of fiscal year 2002 may be affected by fluctuations in mail volumes. Further, USPS health care premium costs are budgeted to increase 10 percent; however, this target may be exceeded as general health insurance premium costs are expected to grow 13 percent, according to an Office of Personnel Management (OPM) announcement in September 2001. Adding to financial pressures, the recent incidents of anthrax in the mail have heightened the need to improve mail safety and security, which will likely entail USPS's incurring additional unplanned expenses.
Security and Safety Needs
Exacerbate Financial Problems

USPS has taken steps to increase mail security and safety, such as decontaminating facilities affected by anthrax, irradiating some mail received by the federal government, and issuing protective equipment to its employees. In the future, USPS faces the challenge of safeguarding employees and customers from bioterrorism, chemical, radiological, and explosive threats. On December 10, 2001, we held a conference of representatives from Congress, USPS, and other postal stakeholders to discuss possible options to enhance mail security and postal operations. Our report on the conference listed numerous options for USPS and the mailing industry to make improvements in this area. It is unclear, however, what changes will ultimately be implemented, what the associated costs will be, and how they will be financed—beyond the $675 million that has been appropriated for this purpose.

Revenues from Rising Postal Rates

USPS's 2000 request for a rate increase was implemented in two stages—in January and July 2001—due to differences between USPS and the PRC over the disposition of the rate case. In addition, USPS requested an above-inflation increase in postal rates in September 2001 that is expected to be implemented in the summer of 2002. Table 3 shows these and other rate actions in calendar years 2000, 2001, and 2002. These increases may not be enough to keep USPS from asking for another rate increase later this fall. During fiscal year 2001, USPS planned to generate an additional $900 million dollars from rate increases that averaged about 6.0 percent. However, the rate increases did not occur as USPS planned because the PRC recommended rate increases averaging 4.6 percent. USPS's governors later overrode PRC's recommended rates in May 2001 and approved rate increases that would generate revenue that was close to USPS's original request. The timing for implementing these rate increases reduced the amount of revenue in fiscal year 2001 by about $390 million below USPS's budget, according to USPS.

9 GAO-02-315SP.
**Table 3: Recent Postal Rate Actions**

<table>
<thead>
<tr>
<th>Date</th>
<th>Action</th>
</tr>
</thead>
<tbody>
<tr>
<td>January 12, 2000</td>
<td>USPS requested postal rate increases averaging approximately 6.0 percent, with a 1-cent increase in the First-Class stamp rate to 34 cents. Rates would take effect after PRC review (not to exceed 10 months) and USPS's Board of Governors action (approval, allow under protest, modify, or reject).</td>
</tr>
<tr>
<td>November 13, 2000</td>
<td>The PRC issued a recommended decision with rate increases averaging 4.6 percent with a 1-cent increase in the First-Class stamp rate.</td>
</tr>
<tr>
<td>December 4, 2000</td>
<td>USPS's Board of Governors voted to allow under protest PRC's recommendation. It also sent the case back to the PRC for further consideration.</td>
</tr>
<tr>
<td>January 7, 2001</td>
<td>USPS implemented rate increases averaging 4.6 percent.</td>
</tr>
<tr>
<td>May 7, 2001</td>
<td>USPS's Board of Governors voted unanimously to modify PRC's recommended decision, with rate increases averaging 1.6 percent to generate revenues similar to those that USPS had requested in the rate case.</td>
</tr>
<tr>
<td>July 1, 2001</td>
<td>USPS implemented rate increases averaging 1.6 percent.</td>
</tr>
<tr>
<td>September 24, 2001</td>
<td>USPS requested rate increases, which it estimated would average 8.7 percent, with a 3-cent increase in the First-Class stamp rate to 37 cents.</td>
</tr>
<tr>
<td>Fall-Winter 2001</td>
<td>The Chairman of the PRC directed rate case participants to consider the option of a negotiated settlement, considering terrorist incidents and their potential effect on USPS. USPS, major customers, and PRC's Office of the Consumer Advocate, among others, are negotiating a proposed settlement in which rates would increase no sooner than June 30, 2002, and include a 3-cent increase in the price of a First-Class stamp.</td>
</tr>
</tbody>
</table>

Sources: USPS and PRC data.

USPS filed for another rate increase in September 2001, which USPS estimated would increase rates an overall average of 8.7 percent, as shown in table 3, and asked the PRC to give this request expedited consideration. Following the terrorist attacks, the chairman of the PRC suggested that the parties in the rate case agree to a settlement, so that the PRC could issue a recommended decision as soon as possible. Recently, the parties entered into negotiations and if the proposed agreement is implemented as expected in the summer of 2002, the price of a First-Class stamp would rise to 37 cents and revenues, according to USPS, would increase by about $1 billion in fiscal year 2002.

Since postal reorganization was implemented in 1971, rates for the First-Class stamp have generally tracked the rate of inflation. More recently, however, rates for certain categories of mail have been increasing at a rate greater than inflation. Some of these categories, such as Priority Mail and Standard Mail, are more price-sensitive than First-Class Mail because of the availability of other alternatives, such as FedEx, UPS, newspaper advertising, and other forms of advertising. Hence, rate increases affect the volumes and competitiveness of mail, particularly the categories that
are the most price-sensitive. Mailers have been critical of the growing frequency and size of rate increases and may look for other communication and delivery alternatives.

Although it is difficult to determine the impact of specific factors, recent declines in mail volume have generally been attributed to rate increases; the continuing recession; anthrax incidents; and increased competition, among other things. Thus, in the first quarter of fiscal year 2002, First-Class Mail, Standard Mail, and Priority Mail volumes fell, compared with the same quarter last fiscal year, by 2 percent, 9 percent, and 17 percent respectively. For the remainder of fiscal year 2002, USPS will be challenged to meet budgeted revenue targets on the basis of volume and revenue forecasts that were prepared before the terrorist incidents and when the economic outlook was more favorable. However, USPS is anticipating additional revenues that were not included in the original budget from a rate increase that may be implemented in the summer, rather than in the fall, of 2002. Another potential source of funding would be any additional funds appropriated by Congress.

Revenues from Additional Appropriations

In the fall of 2001, USPS asked Congress to appropriate about $5 billion to cover costs related to the terrorist and anthrax-related incidents as well as their expected negative effect on revenues. USPS subsequently asked for $1.3 billion to cover expenditures related to these incidents through June 2002. To date, Congress has appropriated $675 million to cover these costs. This is the first appropriation since fiscal year 1982 for purposes other than revenue forgone on free and reduced rate mail. In addition, USPS asked for nearly $1 billion in its fiscal year 2003 appropriation request, representing the total amount of revenue forgone for free and reduced rate mail between 1991 and 1998, for which USPS had not yet received appropriations. This request would be in lieu of the current payment schedule established by a 1993 law for $29 million annual

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10 USPS was allocated $175 million out of emergency supplemental appropriations for fiscal year 2001. These funds are to be used in part to purchase mail sanitization equipment, for employee safety measures, and for other expenses related to the anthrax attacks. An additional emergency supplemental appropriation of $500 million was provided in fiscal year 2002 for emergency expenses to buy equipment for sanitizing and screening mail and to protect postal employees and customers from biohazardous material.

11 USPS receives annual appropriations for revenue forgone, providing free and reduced rate mail for the blind, and providing overseas voting materials for U.S. elections. Congress appropriated about $96 million to USPS for these purposes for fiscal year 2001.
appropriations over 42 years. Also, it is unclear whether USPS will ask for further appropriations to cover security-related expenses in the future.

Cash-Flow Difficulties and Increasing Debt Result in Underfunded Capital Needs

Historically, cash flow from USPS's operations generally has not been sufficient to cover the capital outlays it has needed to maintain, expand, and modernize its physical infrastructure. In each year of this period, USPS capital outlays have exceeded its capital depreciation, and estimated depreciation has served to help cover future capital outlays when making rate case requests. Currently, cash flow from USPS operations is insufficient to fully fund its operational and capital investment needs and repay its debts. Thus, USPS has resorted to using debt to finance its capital outlays. USPS had budgeted its debt to reach $12.9 billion by the end of fiscal year 2002, which would be $2.1 billion below its $15 billion statutory debt limit. If higher postal rates are implemented this summer, cash flow should improve in the short term. However, in the long term, simply raising rates alone is not the answer. Such increases are likely to help facilitate the shift of mail to electronic and other delivery alternatives.

To conserve cash in fiscal year 2002, USPS's budget has extended its freeze on capital commitments for most facility projects and has cut back its overall capital expenditures. USPS has reduced its capital commitments to a level below that of recent years. USPS capital commitments, which had exceeded $3 billion from fiscal years 1997 through 2000, were reduced from $3.6 billion to $1.0 billion in fiscal year 2001 and are budgeted at $2.4 billion in fiscal year 2002. Capital outlays also have experienced a downward trend, although to a lesser extent. Recent reductions in capital commitments and outlays are shown in table 4.

12 Only facility projects related to providing a safe working environment and emergency purposes are to be permitted funding approval.
Table 4: USPS's Cash Flows and Capital Investments in Fiscal Years 2000 through 2002

<table>
<thead>
<tr>
<th>Categories</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Approved budget</td>
<td>Actual</td>
<td>Approved budget</td>
</tr>
<tr>
<td>Cash flow from operations</td>
<td>$1.7</td>
<td>$1.2</td>
<td>$1.8</td>
</tr>
<tr>
<td>Capital cash outlays</td>
<td>3.6</td>
<td>3.3</td>
<td>3.5</td>
</tr>
<tr>
<td>Capital expenditure commitments</td>
<td>4.0</td>
<td>3.0</td>
<td>3.6</td>
</tr>
</tbody>
</table>

Source: USPS financial data.

USPS has a growing backlog of facility projects and is unable to fully finance needed improvements to its infrastructure. The capital freeze on most facility projects and limited funding of other capital projects is unsustainable, given USPS's need to maintain its massive and growing infrastructure and modernize its information technology. Limitations on capital investment may have the following detrimental effects:

- deterioration of USPS's existing physical infrastructure;
- operational impediments from delays in repairing deteriorating facilities or expanding to cover new delivery points;
- higher future capital project costs;
- deferred efficiency gains that could limit cost savings and add pressure to increase postal rates;
- higher costs and rates that could make electronic and other delivery alternatives more attractive; and
- products becoming less competitive as a result of delays in implementing improvements, such as an information platform to enable real-time data on the status of mailings.
Long-Term Need for Funds

USPS is likely to continue experiencing difficulty generating sufficient funds to cover its increasing funding needs (see fig. 4). Funds are needed for (1) current operating expenditures; (2) capital projects; and (3) paying liabilities and servicing its debt. However, expense growth has outpaced revenue growth, capital projects have been significantly curtailed, and USPS's liabilities have exceeded its assets by $2.3 billion, as of September 30, 2001. Included in this calculation of the $2.3 billion is a deferred retirement asset of $32 billion, which is an intangible asset that is not an economic resource that USPS can apply to cover its liabilities. If this $32 billion deferred retirement asset were to be excluded from total assets, USPS's liabilities would exceed its assets by $34.3 billion as of September 30, 2001.

Further, liabilities have been growing at an increasing rate and include $32 billion in retirement liabilities, $11.3 billion in outstanding debt, and a $6.0 billion liability for workers' compensation claims as of September 30, 2001. These liabilities do not include future anticipated interest expenses, such as the $15.8 billion interest expense on the $32 billion retirement liability, or a large obligation for retiree health insurance premiums, which USPS is required by law to pay. The $32 billion retirement liability continues to increase because USPS's annual payments, set by OPM under statutory requirements, have been less than the annual increases in future liabilities. These annual increases are due to increases in employee compensation and mandated retiree cost-of-living adjustments (COLA).

11 USPS financial statements do not record or disclose an obligation for retiree health benefits, because USPS reports that it is part of a multiemployer plan and thus is not required under accounting standards to include it in its balance sheet. However, the Omnibus Budget Reconciliation Act of 1990 (P.L. 101-508) requires USPS to pay a share of health insurance premiums for all employees, and their survivors, who participate in the Federal Employees Health Benefits Program and who retire on or after July 1, 1971. A USPS-sponsored study estimated in 1991 that this obligation was roughly $45 billion. More recent estimates on the amount of this obligation are not available.
Figure 4: USPS's Need for Funds Outweighs Its Sources of Funds

Source: USPS financial data.

USPS also had an accumulated deficit of $5.4 billion as of September 30, 2001. The accumulated deficit represents the amount by which annual deficits have exceeded annual positive net income since USPS's inception. Deficits arise when expenses exceed revenues. When expenses require payment and there is insufficient cash flow from operations, USPS may borrow, thus increasing its liabilities and the need for funds at some future point to pay the liabilities. A mechanism known as the Prior Years' Losses
Recovery (PYLR)\(^{14}\) permits USPS to include in its rate request an amount above its expected costs to make up for past operating losses over a future period of time. Starting with the 1980 rate case, USPS has submitted, and the PRC has recommended, a provision for the recovery of prior years' losses over a 9-year amortization period. By decreasing the amortization period to recoup losses—for example, to the 7-year amortization period that was used in the two rate cases before 1980—USPS could implement larger rate increases in an attempt to generate net income to cover its accumulated deficits more rapidly.

USPS continues to depend on borrowing and has not indicated how it plans to reduce its debt. USPS has not generated sufficient cash flow from operations to cover capital outlays in 11 of the last 15 fiscal years. USPS's outstanding debt balance has grown steadily since fiscal year 1997, nearly doubling from $5.9 billion to $11.3 billion at the end of fiscal year 2001 (see fig. 5). This trend of increasing debt levels essentially shifts the burden of reducing the debt from current to future ratepayers and creates pressure for USPS to raise postal rates in the future. Although this debt is not guaranteed by the government,\(^{15}\) if future ratepayers are unable to reduce this debt, Congress could determine that the government should step in to pay some or all of these obligations. Simply borrowing to keep USPS operating is not acceptable as a long-term option and is contrary to USPS's mandate to be self-supporting.

\(^{14}\) See USPS Board of Governors Resolution 95-9. PYLR is a means for USPS to repay its accumulated deficit balance and thereby restore positive equity.

\(^{15}\) By statute (39 U.S.C. § 2006(c)), USPS can request the secretary of the Treasury to have the U.S. government guarantee its obligations; but, according to a USPS official, USPS has never made such a request.
Figure 5: Trends in USPS's Debt, Fiscal Years 1972 through 2002

Key options that USPS could consider to improve its financial condition include increasing revenues and cutting costs. USPS needs sufficient revenues so that it can cover operating costs and improve net income, address the growing backlog of capital projects, expand to meet new delivery point needs, continue modernization efforts, and reduce its debt. On the revenue side, USPS has two basic options for increasing revenues: (1) generate additional revenues from increasing volumes, improving existing products, and developing new products and services and (2) increase rates, possibly by increasing the rate of recovery of prior years’ losses in rate cases and/or increasing the amount for capital purposes from depreciation to a higher figure. On the expense side, USPS can reduce

16 The law includes a provision for sinking funds or other retirements of obligations to the extent that such provision exceeds applicable depreciation charges. See 39 U.S.C. § 3621. This provision has never been used.
expenses by cutting costs and improving productivity. Options related to cutting costs and improving productivity are further discussed in the next section of this report. As for increasing revenues from new products and services, in recent years USPS has generally had difficulty generating positive net revenues. For example, in fiscal year 2001, USPS budgeted $104 million for revenues from its e-commerce initiatives, but reported actual revenues of only about $2 million in this area. In addition, increasing rates has traditionally been the primary source of new revenue, particularly from the largest mail categories—First-Class Mail and Standard Mail. In the short term, USPS can realize large net revenues by increasing postal rates, especially for less price sensitive categories, such as First-Class Mail. However, in the long term, increasing rates may have diminishing practicality because rate increases affect USPS’s competitiveness by increasing incentives for mailers to find other alternatives to the mail. Therefore, it is important for USPS to undertake transformation efforts to operate more efficiently in order to hold down rate increases over the long term.

On the financing side, USPS has increasingly relied on additional borrowing to fund its capital expenditures. A major constraint is that USPS may soon reach its statutory borrowing limit. However, raising the debt limit would require congressional action. In the short term, USPS may need to rely on additional borrowing if it is to maintain its capital program, but increasing debt in the long term would not be prudent.

Another option for obtaining additional funding would be to request additional appropriations from Congress. Such a request would appear counter to Congress’s intent of establishing a self-financing independent entity in 1970 when it reorganized the former Post Office Department to the current U.S. Postal Service.

Transformation Required to Make USPS Financially Viable

A comprehensive transformation of the Postal Service is needed to ensure its financial viability and fulfill its mission in the 21st century in the dynamic communications and delivery sectors. Legal requirements and practical constraints have contributed to continuing deficits, rate increases, rising costs, and growing debt. USPS has attempted to reduce the size of rate increases by cutting costs and increasing its productivity, but it has been able to achieve only limited progress. More progress is urgently needed, and a range of options for making improvements is available within the current structure. However, absent a fundamental reassessment of USPS’s statutory framework, starting with its mission and role, USPS will continue
to be constrained in its transformation efforts. For example, USPS’s statutory framework, which includes a monopoly on letter mail, a break-even mandate, and a cost-of-service rate-setting structure, provides limited incentives for USPS to cut or restrain costs or to be innovative. Furthermore, USPS faces legal and practical constraints related to restructuring its infrastructure, including closing or consolidating postal facilities and realigning its workforce as its operations change. Other structural issues, such as USPS’s governance structure, have been raised—that is, what type of governing board is appropriate for USPS given the complex mission and role of this $70 billion entity. USPS’s basic business model, which assumes that rising mail volume will help cover rising costs and mitigate rate increases, is increasingly problematic as mail volume either stagnates or further declines while costs continue to rise.

A comprehensive transformation is urgently needed, starting with actions that USPS can take under its current authority. Given USPS’s dire financial situation, interim legislative changes could serve a valuable purpose. However, action by Congress on comprehensive transformation issues will be critical to ensuring financial viability. Leadership—starting with USPS—will be critical to achieving the necessary consensus for transformation between Congress and the divided stakeholder community.

Need for Transformation

The statutory framework under which USPS operates, established under the Postal Reorganization Act more than 30 years ago, is increasingly problematic and is long overdue for change. The act was enacted when USPS faced little direct competition and could rely on increasing rates, coupled with growing mail volumes, to cover rising costs. Today, USPS must operate in a vastly different environment. The World Wide Web, which came into widespread use in the 1990s, along with cell phones have become essential elements of communications and commerce. E-mail use has exploded, more and more documents are being sent electronically, and a growing share of payments has also shifted from mail to electronic alternatives. These changes continue, mail volume has started to decline, and the prospect is for future declines over the long run. In contrast, USPS’s business model, developed pursuant to the Postal Reorganization Act, has remained virtually unchanged for the past 30 years.
Postal transformation efforts are limited by a combination of legal requirements and related practical constraints (see table 5).

### Table 5: Key USPS Legal Requirements and Practical Constraints That Limit Transformation Efforts

<table>
<thead>
<tr>
<th>Legal requirements</th>
<th>Practical constraints</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Universal postal service</strong></td>
<td>• Strong stakeholder opposition to cuts in the frequency or quality of postal services.</td>
</tr>
<tr>
<td>• USPS shall have as its basic function the obligation to provide postal services</td>
<td>• Self-imposed delivery standards (e.g., delivery of local First-Class Mail overnight and long-distance First-Class Mail in 2-3 days).</td>
</tr>
<tr>
<td>to bind the nation together through the personal, educational, literary, and business</td>
<td>• Current availability of more than 300,000 collection boxes and collection of outgoing mail at post offices.</td>
</tr>
<tr>
<td>correspondence of the people.</td>
<td>• Current practice of delivering residential mail to individual mailboxes, including those attached to the home, rather than requiring more efficient distribution methods such as curbside or cluster boxes.</td>
</tr>
<tr>
<td>• USPS shall provide prompt, reliable, and efficient services to patrons in all</td>
<td></td>
</tr>
<tr>
<td>areas, render postal services to all communities, and serve as nearly as practicable</td>
<td></td>
</tr>
<tr>
<td>the entire U.S. population.</td>
<td></td>
</tr>
<tr>
<td>• USPS shall provide a maximum degree of effective and regular postal services to</td>
<td></td>
</tr>
<tr>
<td>rural areas, communities, and small towns where post offices are not self-sustaining.</td>
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</tr>
<tr>
<td>• At least one category of mail must be delivered at a uniform rate throughout the</td>
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</tr>
<tr>
<td>United States and its territories and possessions.</td>
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</tr>
<tr>
<td>• The PRC must issue an advisory opinion prior to changes in the nature of postal</td>
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<td>services that will generally affect service on a nationwide or substantially</td>
<td></td>
</tr>
<tr>
<td>nationwide basis.</td>
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<tr>
<td>• Those who believe they are not receiving postal services in accordance with the</td>
<td></td>
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<tr>
<td>policies of Title 39 of the U.S. Code may lodge a complaint with the PRC, which, if</td>
<td></td>
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<td>it found the complaint to be justified, would render a recommended decision or public</td>
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<td>report on the matter.</td>
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<tr>
<td>• For many years, USPS appropriations have been contingent on 6-day delivery and</td>
<td></td>
</tr>
<tr>
<td>rural delivery of mail at not less than the 1993 level.</td>
<td></td>
</tr>
<tr>
<td><strong>Postal monopoly</strong></td>
<td></td>
</tr>
<tr>
<td>• Only USPS can deliver letter mail, with “letters” being defined by USPS in</td>
<td></td>
</tr>
<tr>
<td>regulations. USPS has suspended the letter mail monopoly in its regulations for</td>
<td></td>
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<tr>
<td>extremely urgent letters and outbound international mail.</td>
<td></td>
</tr>
<tr>
<td>• Only USPS can put mail in recipients’ mailboxes, with specific restrictions</td>
<td></td>
</tr>
<tr>
<td>detailed in USPS regulations.</td>
<td></td>
</tr>
<tr>
<td>• USPS’s monopoly helps it maintain universal postal service, including uniform</td>
<td></td>
</tr>
<tr>
<td>frequency of delivery on every route and uniform, reasonable rates.</td>
<td></td>
</tr>
<tr>
<td>• USPS’s monopoly prevents direct competition, which could create additional</td>
<td></td>
</tr>
<tr>
<td>incentives for innovation and competitive prices and service quality.</td>
<td></td>
</tr>
<tr>
<td><strong>Financial</strong></td>
<td></td>
</tr>
<tr>
<td>• There is a $15-billion limit on total USPS debt; and annual increases are limited</td>
<td></td>
</tr>
<tr>
<td>to $3 billion in USPS obligations, including $2 billion for capital improvements</td>
<td></td>
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<tr>
<td>and $1 billion to defray operating expenses.</td>
<td></td>
</tr>
<tr>
<td>• USPS must invest and borrow through the U.S. Treasury or obtain Treasury approval</td>
<td></td>
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<tr>
<td>to do otherwise.</td>
<td></td>
</tr>
<tr>
<td>• If USPS were to request investing or borrowing outside the Treasury, obtaining</td>
<td></td>
</tr>
<tr>
<td>Treasury’s approval may be difficult, because historically Treasury has favored</td>
<td></td>
</tr>
<tr>
<td>having USPS conduct its financing through the Treasury.</td>
<td></td>
</tr>
</tbody>
</table>

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(Continued From Previous Page)

<table>
<thead>
<tr>
<th>Legal requirements</th>
<th>Practical constraints</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retail facilities</td>
<td>---------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>• Prohibition on closing small post offices solely for operating at a deficit.</td>
<td>• USPS's self-imposed moratorium on closing post offices.</td>
</tr>
<tr>
<td>• Statutory process and criteria for post office closings, including appellate review by the PRC.</td>
<td>• Strong opposition to post office closings, consolidations, and relocations from the local community, affected members of Congress, and others opposed to closing post offices and/or relocating post offices away from downtown areas.</td>
</tr>
<tr>
<td>• Processes for closing, consolidating, and relocating post offices further prescribed in USPS regulations.</td>
<td></td>
</tr>
<tr>
<td>• For many years, USPS has been prohibited from using its annual appropriations from Congress to consolidate or close small rural or other small post offices in the fiscal year covered by the act.</td>
<td></td>
</tr>
<tr>
<td>Mail-processing facilities</td>
<td>---------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>• Requirements for closing, consolidating, or relocating post offices specified in USPS regulations may be applicable to a mail-processing facility that includes a post office.</td>
<td>• Stakeholder opposition that may include affected workers, local communities, mailers, and members of Congress.</td>
</tr>
<tr>
<td></td>
<td>• Lack of funds to finance the up-front costs of consolidations.</td>
</tr>
<tr>
<td>Human capital</td>
<td>---------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>• The federal pay cap is made applicable to postal pay.</td>
<td>• Adversarial labor-management relations.</td>
</tr>
<tr>
<td>• Postal compensation and benefits for all officers and employees required to be comparable to those of workers in the private sector.</td>
<td>• Long-standing work rules in agreements with USPS's four major unions could complicate realignment efforts, such as work rules relating to the operational full-/part-time ratio dating from the 1970s. In 1991, the allowable full-/part-time ratio changed from 90/10 to 80/20 for clerks and 88/12 for carriers. In 1994, USPS agreed to double-time above 60 hours per week and other overtime procedures.</td>
</tr>
<tr>
<td>• Collective bargaining is required for unionized employees, including mediation followed by binding arbitration by a third-party panel when the parties are unable to agree.</td>
<td>• Another area where the work rules may vary by union contract involves no-layoff provisions. In the most recent contract with USPS's largest union, the no-layoff provision was modified to include all of its workers hired after November 2000.</td>
</tr>
<tr>
<td>• USPS is required to provide a program of consultation with management and supervisory associations, and such organizations are entitled to participate directly in the planning and development of compensation and benefit programs.</td>
<td>• A huge number and backlog of grievances is costly and contributes to workplace tension.</td>
</tr>
<tr>
<td>• USPS must establish a grievance process.</td>
<td></td>
</tr>
<tr>
<td>Rate-setting and regulatory structure</td>
<td>---------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>• Postal rates and fees shall provide sufficient revenues so that USPS's total estimated income and appropriations will equal as nearly as practicable its total estimated costs—a requirement interpreted to mean that USPS should “break-even” over time. On the basis of law, regulation, and precedent, USPS costs include operating costs, depreciation, a portion of prior years' losses, and a contingency. Each mail category must cover its costs, a requirement that has been applied at the subclass level. This cost-based system is referred to as a cost-of-service regulation.</td>
<td>• In practice, postal revenues have not covered costs, resulting in the accumulation of prior years' losses and debt that is approaching the statutory limit.</td>
</tr>
<tr>
<td>• An independent body, the PRC, must review USPS proposals to change domestic postal rates and fees.</td>
<td>• Persistent disagreements between USPS and the PRC on pricing matters and the quality of data used for rate-setting purposes.</td>
</tr>
<tr>
<td></td>
<td>• USPS can shield proprietary information from disclosure, the PRC has no subpoena power, and the PRC cannot compel USPS to conduct special studies for rate-setting purposes.</td>
</tr>
</tbody>
</table>
Legal requirements

• The PRC is required to provide due process to interested parties and has up to 10 months to issue a recommended decision. Rate cases follow specific procedures set by statute and PRC regulations. Rate case precedents also help define what data must be submitted.

• USPS’s governors may approve, allow under protest, reject, or modify PRC’s decision. Modification can only be made by a unanimous vote when the governors find it is in accord with the record and applicable laws and if recommended rates are not consistent with the break-even provision listed above.

• In recommending rates, the PRC must apply nine statutory criteria, such as the establishment and maintenance of a fair and equitable schedule. Rate case precedents also help guide the establishment of rates, including their markups over attributable costs.

• Reduced rates must be provided for nonprofit groups, classroom mail and library mail; free mail must be provided to the blind, and overseas voting materials must be delivered free.

• Except as authorized by law (e.g., see above bullet), USPS shall not make undue or unreasonable discrimination or preference among users—a provision referred to as the nondiscrimination clause.

• The PRC must review proposed changes to the mail classification system and issue a recommended decision. This authority, which covers proposed new domestic postal products and services to be offered on a permanent or experimental basis, is further detailed in PRC regulations.

• The PRC is authorized to consider rate complaints and issue a recommended decision.

• USPS must report annually the costs, revenues, and volumes of international mail to the PRC, which then issues a report to Congress.


Limited Progress Made to Increase Productivity

USPS has had long-standing difficulty in its efforts to increase postal productivity. In general, USPS has high fixed costs, and it has been difficult for it to cut costs quickly when expected mail volumes and revenues fail to materialize. To achieve real savings and productivity improvement, USPS would need to decrease unneeded capacity resulting from efficiency gains and increase capacity only where such an increase is needed. USPS data show that its productivity has increased only 11.5 percent over the past 3 decades (see fig. 6), and these limited productivity gains have resulted in postal costs and rates being higher than they otherwise would have been. Postal productivity decreased 0.7 percent from fiscal years 1990 to 1999, despite billions of dollars invested in automation and information technology over that period. USPS made renewed progress in improving
productivity in fiscal years 2000 and 2001, a period when its productivity rose 3.6 percent. However, these gains may be difficult to sustain. USPS has budgeted for a productivity increase of 1.1 percent in fiscal year 2002, but its productivity decreased at a 1.1-percent annualized rate in the first quarter, primarily due to mail volume declines following recent terrorist incidents.

Figure 6: Cumulative Postal Productivity Growth from Fiscal Years 1971 through 2001

Source: USPS data.

Stakeholders have offered a variety of explanations for why USPS productivity has not increased more substantially over the years. These explanations include factors such as poor management; continuing waste and inefficiency; legal requirements and practical constraints; increasing compensation costs; adversarial labor-management relations; and insufficient incentives for USPS, a government entity with a break-even requirement, a statutory monopoly, and cost-of-service regulation, to improve its financial performance. Although it is difficult to estimate the effects, if any, of these factors, it is worth noting that over the past decade, USPS has not been able to take full advantage of its capital investments through increases in labor productivity. Numerous reports, including some
by us, have noted inefficiencies in the postal system and difficulties that
USPS has had in realizing opportunities for savings. For example, in 1998,
we reported that USPS had achieved savings in carrier work hours through
automated rather than manual sorting of letters into the exact order that
carriers deliver them, but these savings had fallen short of USPS goals, in
part due to labor-management issues.\textsuperscript{17}

A related problem has been USPS's difficulty in tracking specific costs and
the results of various cost-saving initiatives. In March 2000, USPS
highlighted its intention to save $1 billion from specific productivity and
cost-saving initiatives in operations, administration, purchasing, and
transportation. Although USPS has estimated that it saved $900 million in
fiscal year 2001 from increasing its overall productivity, it did not report—
and may not be able to produce reliable data on—specific savings from its
productivity initiatives. USPS plans to implement an activity-based costing
system in mail-processing facilities in the near future that would track
specific costs that could be compared across different locations. Such
information would help USPS managers plan, prioritize, and track the
results of future cost-saving efforts.

Improvements to Postal Operations Are Urgently Needed

Although efforts may be limited by legal requirements and practical
constraints, USPS can do more in the short term under its current authority
to drive out costs and thereby increase productivity. In the longer term,
more fundamental structural changes will be needed before USPS can
achieve significant cost savings. In addition to operational efficiency,
measures to enhance mail safety and security also need to be considered.
Key areas where USPS is moving to take action under current law include
the following:

\textsuperscript{17} U.S. General Accounting Office, \textit{U.S. Postal Service: Progress Made in Implementing
Automated Letter Sequencing, but Some Issues Remain}, GAO/GGD-98-73 (Washington,
• Maximize efficiency of current mail-processing facilities: Productivity varies greatly across mail-processing facilities. Implementing best practices throughout the organization would give USPS the opportunity to increase the productivity of its lower performing plants. Consistent with this idea, a recent review identified instances of wide variation in equipment utilization and inconsistent execution of strategies for effective utilization.\textsuperscript{18} The 2001 Mailing Industry Task Force recommended that the mailing industry and USPS collaborate to standardize mail-processing functions to increase efficiency.\textsuperscript{19}

• Consolidate mail-processing facilities: Although USPS reports that it has recently studied whether to consolidate postal facilities, it has not released the results of the study, and no consolidations have yet been made. USPS could develop a plan that outlines its current and expected future needs for mail-processing facilities and specify changes to address these needs.

• Continue automation: USPS recognizes that it is further along in automating the processing of letter mail than it is in automating flat mail, such as periodicals and catalogs, and it is currently deploying more efficient flat sorting machines. Its vision for mail processing and delivery is to replace its current process of multiple bundles for letters and flats with a single bundle for each delivery point. USPS has developed a plan for achieving much of its vision that calls for implementing new and enhanced automation over much of the next decade.

• Deploy the information platform: USPS is in the process of deploying an information platform to provide reliable, real-time information on mailings; data on processing and delivery problems; and improved workforce management. However, completion of the platform is expected to take years, and mailers have urged USPS to make more rapid progress.


• **Explore mail redesign:** USPS is exploring redesign of the mail classification system and rate structure, also called “mail redesign,” to change the postal pricing system to provide additional incentives for efficiency. The concept is to create more homogeneous groups of mail and increase emphasis on cost-efficient preparation.

• **Work with the unions to improve staffing options:** Better alignment of the workforce with operational needs, such as changes to work rules and job assignments, may be possible within the scope of existing national contracts. For example, one field office has reported working with local unions to amend the work rules to allow greater flexibility in addressing staffing issues at specific locations.

• **Continue to work with mailer groups and other stakeholders to identify additional opportunities for cutting costs and improving productivity:** USPS has been working closely with mailer groups and other stakeholders to identify additional opportunities for cutting costs and improving productivity. That continuing work has yielded many recommendations and improvements. For example, a recent review made recommendations for both USPS and flats mailers, such as adoption of more efficient USPS processes and improved packaging to reduce costly bundle breakage. In addition, USPS recently reported that it plans to work collaboratively with the PRC and interested customers to explore various alternatives relating to negotiated service agreements—in which certain mailers would perform additional worksharing activities and receive larger discounts.

• **Improve workforce planning:** USPS could broaden its workforce planning from the current focus on the next 3 years to a longer horizon. Long-term planning could address changes in automation; mail volume and mix; and security and safety issues, among other things. Such planning could review needs related to the appropriate number, skills, deployment, and part-time or full-time status of employees. Long-term planning could also address succession and continuity issues as most USPS managers and half of the workforce reaches retirement eligibility over the next decade.

• **Examine alternatives for providing retail services:** USPS is exploring ways to expand the use of various alternatives to sell stamps and mail packages. About 80 percent of customer visits to post offices are for the purpose of mailing letters, purchasing stamps, or a combination of the two activities. According to USPS, it costs 22 cents per $1 of revenue to
sell stamps at a post office counter, compared with 14 cents from vending machines; it costs 1.3 cents through outlets such as grocery stores and ATMs. USPS has also tested a self-service machine: customers weigh parcels, purchase postage, pay by credit card, and place the parcels in a secure container for delivery. Additional opportunities may exist for USPS to decrease costs and provide enhanced service by partnering with and using other organizations’ facilities. Likewise, USPS may also be able to generate revenue by partnering with other organizations that could use available space in postal facilities to provide compatible services.

- **Review access to postal services:** Another area for potential savings relates to the accessibility of receptacles that customers use to send and receive mail. USPS has options for savings by altering the mix of customer receptacles used to receive mail (e.g., cluster boxes and/or curbside mailboxes versus mailboxes attached to residences). In addition, after the incidents of anthrax in the mail, there has been much discussion regarding whether USPS should enhance safety by reducing the number of street side collection boxes and/or changing their design to provide a narrower slot for the mail.

**USPS Needs to Reassess Structural Issues and Take Action**

USPS can make some improvements within the current structure, but these improvements will not be enough for long-term sustainability. Less than a year after we placed USPS’s transformation efforts and long-term outlook on our High-Risk list, USPS’s financial situation has deteriorated, while structural issues and limitations remain unresolved. USPS’s ability to fulfill its mission by providing the current level of universal postal service at reasonable rates on a self-supporting basis is at increasing risk.

USPS’s 30-year-old system of postal laws is increasingly problematic for USPS and its competitors and is overdue for change to ensure that USPS’s basic business model is viable. Three key themes to address in comprehensive transformation include reassessing (1) USPS’s statutory framework, beginning with its mission and role in the 21st century; (2) insufficient incentives for USPS, a governmental entity with a break-even mandate, a statutory monopoly on letter mail, and cost-of-service regulation; and (3) the legal requirements and practical constraints that limit transformation efforts, including those relating to USPS’s infrastructure and workforce. Other structural issues, such as USPS’s governance structure, have been raised—that is, what type of governing
board is appropriate for USPS, given the complex mission and role of this $70 billion entity.

Postal Service's Mission and Role

The starting point for postal transformation is a reassessment of USPS's mission and role. Vast changes in the communications and delivery sectors over the past 30 years—which are continuing at a rapid pace—as well as USPS's growing financial difficulties, provide an impetus for reconsidering what universal postal service will be needed for the 21st century. Key issues include what postal services should be provided on a universal basis to meet customer needs, how these services should be provided, and how they should be financed—by ratepayers or taxpayers. A related issue is what quality of postal service should be maintained, such as the frequency and speed of mail delivery and the accessibility and scope of retail postal services, as well as whether certain aspects of universal postal service should be allowed to vary in urban and rural areas. Depending on the resolution of these fundamental issues, Congress and the stakeholder community can better approach what legal structure would be best suited to enable USPS to fulfill its mission in the 21st century, including what incentives, accountability, and constraints would be appropriate.

Other issues related to USPS's mission and role include the following:

- **Competition:** Should USPS be allowed to compete with the private sector and, if so, on what terms? Which, if any, of the many federal laws, regulations, and taxes that apply to the private sector should apply to USPS? If USPS is allowed to compete, should it retain its current law enforcement powers and authority to issue regulations (e.g., regulations defining the scope of the postal monopoly)? In part because of different taxation and legal treatment, some stakeholders contend that USPS should limit its activities to providing hard-copy delivery services and, when it competes, it should do so on the same terms as its competitors. USPS and some other stakeholders counter that USPS is at a competitive disadvantage due to its current universal postal service mandate and other laws and regulations, and that USPS should have increased flexibility.

- **Public/Private provision of postal services:** Should core postal functions be discharged by a public entity, private companies, or a combination of both? For example, should USPS remain a government entity or should it be privatized? Should USPS perform some functions in partnership with the private sector, allow the private sector to
perform other functions through “worksharing discounts,” or contract out some of its functions? USPS gives worksharing discounts that are based on its cost avoidance, such as accepting mail that is bar coded and/or drop-shipped to the local postal facility, which creates the opportunity for the least-cost provider to perform these activities. Some postal functions have long been provided by a combination of public and private providers, such as mail transportation, processing, retail services, and delivery. USPS has long contracted for mail transportation and currently has a multibillion-dollar contract with FedEx for long-distance transportation of Priority Mail, Express Mail, and First-Class Mail. In addition, contract stations provide postal retail services, and some transportation contractors deliver mail along their routes.

- **Governance:** What type of governing board is appropriate given USPS’s mission and role? How should members be selected, paid, and held accountable? What should the role and functions of the governing board be, and is its current part-time status appropriate? Is the present governance structure best suited to ensuring individuals that are qualified to direct a $70 billion entity? Should the framework follow recent changes in the private sector to (1) develop better-defined criteria for board membership and (2) recognize that various roles on the board may require various backgrounds and skills? These questions are relevant because USPS is intended to function in a businesslike manner.

- **Accountability and transparency:** Should USPS be held more directly accountable for its performance and, if so, to what extent, to whom, and with what mechanisms? Specifically, how should USPS’s Board of Governors be held accountable? What oversight is needed to protect the public interest, including the interest of customers with few or no alternatives to the mail? How should the PRC and/or other pertinent authorities exercise oversight regarding pricing; competition; and antitrust issues, among other areas? What recourse should customers and competitors have to lodge complaints? What should be the role of Congress and other federal agencies in providing accountability and oversight? What information should USPS be required to provide Congress and the public on its performance, including in areas such as financial performance, productivity, and mail delivery? Transparency and accountability are fundamental principles to ensuring public confidence in USPS.
Need to Reassess Legal Framework and Incentives

The current legal framework, which was designed to help USPS fulfill universal service mandates, does not provide the same types of incentives that apply to the private sector. USPS's break-even mandate removes the profit motive, and the rate-setting structure allows USPS to cover rising costs by increasing rates. The postal monopoly shields USPS's core business of letter mail from direct competition, which could provide additional incentives for innovation, efficiency, and competitive prices and quality of service. As part of their postal transformation efforts, a number of foreign countries have made changes to their legal frameworks, including reducing the postal monopoly, that have increased incentives. Although it is difficult to make direct comparisons, their experiences are relevant to consideration of structural change in USPS. Specific structural issues relating to incentives that need to be addressed include the following:

- **The postal monopoly:** Should the postal monopoly be narrowed or eliminated? Congress created the statutory monopoly on letter mail to enable the postal system to fulfill its universal service mandates. USPS has further defined its letter mail monopoly through regulations. Narrowing or eliminating the monopoly could provide incentives for efficiency and innovation for USPS and its competitors and could lead to greater choices for consumers. However, such a step could allow competition for profitable segments of USPS's market. Some believe USPS would have difficulty competing under these circumstances, particularly if it was required to continue the current level of universal service with 6-day delivery of mail to every address and delivery of single-piece First-Class Mail at uniform rates. Others disagree, pointing to USPS's advantages in scope and scale. In this regard, a number of foreign countries have narrowed their postal monopolies in recent years and further steps in this direction are being considered.

- **Break-even mandate:** Can USPS remain self-supporting under its mandate to break even over time? If not, should USPS have a for-profit business model? USPS's break-even mandate was established to foster reasonable rates. Removal of the break-even mandate could create a long-term financial incentive for cost savings that also could be passed along to ratepayers. However, removing the break-even mandate could provide an incentive for reducing the quality and scope of some costly services. For this reason, some other countries whose postal administrations operate on a for-profit basis have imposed specific minimum requirements for universal postal service and added regulatory oversight of the quality of postal service.
• *Rate-setting structure:* Should the current rate-setting process be retained, modified, or replaced with a different system? Are changes to the current rate-setting structure needed to provide sufficient funds for USPS's operating and capital needs and to repay debt? Should USPS rate setting be subject to prior review? What should be the respective authorities of USPS and any independent regulator, including the authority to compel provision of information and final decision-making authority over what rates are set? Should legal requirements that affect rates—including specific cost-coverage requirements, the nondiscrimination clause, and preferred rates for certain groups—be retained, changed, or eliminated? The rate-setting process was created to ensure prior independent review of domestic postal rates and fees that includes due process for all interested parties in hearings on the record. This process has led to proceedings that are often lengthy and adversarial. Although the current system was designed to enable USPS to break even over time, in practice USPS has accumulated significant prior years' losses and debt. Under cost-based rate regulation, limited incentives exist for USPS to control costs because postal rates must be raised to cover expected costs. When cost savings are achieved, these are passed along to customers in the next rate case. Consensus on these issues has been difficult to achieve, but improvements in the rate-setting area are a fundamental component of a comprehensive transformation.

Transformation will also require consideration of legal requirements and practical constraints relating to USPS's physical infrastructure of post offices and mail-processing facilities and to USPS's workforce.

**Transformation:**

**Infrastructure Issues**

Currently, changes to USPS's retail infrastructure are limited by both legal requirements and practical constraints. USPS is required to render postal services to all communities, including providing regular postal services to rural areas, communities, and small towns where post offices are not self-sustaining. USPS must follow specific criteria and procedures set forth in law or regulations for closing or consolidating post offices. For example, it cannot close a small post office solely because it is operating at a deficit. USPS also has a self-imposed moratorium on closing post offices. As a practical matter, members of Congress and other stakeholders have often intervened in the past when USPS has attempted to close post offices or consolidate postal facilities. Proposed post office closures have provoked intense opposition because local post offices (1) have long been a critical means of obtaining ready access to postal retail services, (2) are a part of American culture and business, and (3) are viewed as critical to the
viability of certain towns and/or central business districts. Similarly, changes to USPS's mail-processing infrastructure have been difficult to implement. Although there are no legal requirements relating directly to closing or consolidating mail-processing facilities, as a practical matter, such efforts have been opposed because of the potential effects on jobs and mail delivery service in local communities, their proximity to facilities of large mailers, and congressional interest in the location of mail-processing facilities.

Nevertheless, the issue of how USPS can best provide retail services and process the mail as well as ensure the safety and security of the mail and its employees in the 21st century needs to be addressed. Congress, USPS, and stakeholders need to consider what access to postal retail services is needed, how such access can be provided in an affordable manner, and whether improvements can be made to optimize the postal infrastructure to support changes in operations while also supporting customer convenience and access. For example, USPS could provide more convenient retail services at more locations, such as ATMs or at grocery stores, rather than in traditional brick-and-mortar post offices. In addition, recent terrorist incidents have raised new safety and security issues related both to postal employees and customers that need to be addressed. As discussed later in this report, a process similar to the one used for military base closing may be useful for addressing sensitive postal facility closure and consolidation issues.

Transformation: Human Capital Issues

In addition to limitations on changes to its infrastructure, changes to USPS's human capital, or workforce, also face limitations. USPS is required by law to maintain compensation and benefits for all of its employees on a standard comparable to the compensation and benefits paid for comparable levels of work in the private sector. Further, when contract disputes cannot be settled between postal labor and management, they must be settled by a third party through binding arbitration. As a practical matter, postal labor and management have had long-standing adversarial relations.

To improve organization performance, USPS's workforce; performance management systems, including compensation and benefits; and work

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36 Requirements for closing, consolidating, or relocating post offices specified in USPS regulations may be applicable to a mail-processing facility that includes a post office.
rules should be aligned to support organizational mission and goals while appropriately protecting workers' rights. As part of its comprehensive transformation, USPS needs to address several human capital challenges that affect USPS's ability to meet its mission and goals. These include (1) assessing workforce needs to plan for the appropriate number, skills, and deployment of employees and whether USPS has sufficient authority and flexibility to meet changing needs; (2) maintaining the continuity of service as many experienced managers and workers retire and leave the Service; and (3) improving labor-management relations to resolve issues such as developing performance management systems, including pay and other meaningful incentives, to better link performance of all employees with USPS's business goals.

To successfully transform itself into a financially viable postal organization, USPS will need to develop, in collaboration with its labor unions and management associations, a strategy to effectively align its workforce with its business goals and strategies. For example, agreement on business goals between USPS and its labor unions and management associations may facilitate decisions on introducing additional technologies, closing processing facilities and/or consolidating its infrastructure of retail organizations, and making appropriate changes in work rules. Also, USPS officials are anticipating that a large number of its current workers could retire by 2010. Fortunately, the wave of impending retirements creates both challenges and opportunities for USPS to realign its workforce by hiring workers with skills that are needed in the future and deploying its workers at new or different locations while limiting layoffs of current employees.

USPS's current workforce planning process is essentially designed to address short-term needs. USPS develops operationally oriented plans that project the skills and number of workers that it will need for the next 3 years assuming that with some exceptions, USPS will continue to operate as it does now. USPS officials use their plans to identify surpluses or gaps between needs and available staff in certain facilities for each year—with the understanding that second- and third-year projections of workforce needs may be less reliable given USPS's constantly changing business environment.

Workforce planning for a transformation differs from operational workforce planning in several ways. First, workforce planning for a transformation is more long term, primarily because organizations that are as large and complex as USPS generally take several years to implement transformation efforts. Second, a long-term workforce planning process
can help USPS anticipate workforce trends and consider alternative solutions, such as recruiting employees from nontraditional sources. Such a planning process could improve USPS's flexibility in meeting its workforce needs and improving employee relations. Third, long-term planning focuses on broad strategies for meeting workforce needs, with the idea that as the transformation progresses, the organization can develop more specific projections of near-term needs and detailed plans to meet such needs that are consistent with the organization's broad workforce strategy.

In planning for future leaders, USPS is challenged to ensure that it has a sufficient number of managers with the competencies—which are commonly described as knowledge, skills, abilities, and behavior—to lead its workforce. USPS has implemented programs for selecting potential successors for departing executives and training programs to prepare these individuals to be effective managers. However, the programs may not be adequately addressing USPS's long-term leadership needs. According to USPS's Senior Vice President for Human Resources, some USPS managers who otherwise may have been selected to replace retiring officials are themselves leaving the Service. The official estimated that as of November 2001, USPS had qualified staff to replace about 75 percent of the current leadership positions, compared with its goal of about 85 percent. Also, many of the people whom USPS has identified as potential successors are approaching retirement eligibility themselves. This suggests that relying on replacements who are nearing retirement would be only a temporary solution to the succession problem.

Transformation also needs to address the continuing challenge of long-standing disagreements between USPS management and its unions. These differences have extended to performance management issues involving compensation, incentives, and benefits as well as deployment of the workforce. Performance management systems can include pay systems and incentive programs that link employees' performance to specific results and desired outcomes. These tools help focus managers' and employees' efforts toward achieving organizational goals and can be critical to an organization's overall success. Thus, it is important that a plan to transform USPS's mission, goals, and workforce discuss how USPS intends to align managers' and employees' efforts with its mission and goals. The plan should also discuss areas where additional flexibility is needed to make necessary workforce realignments, such as providing early retirement for selected employees and determining whether contract or legislative changes may be needed.
USPS's PMG has stated that USPS is entering a new era of organizational challenges and that aligning compensation-related systems with USPS's goals is key to success in this new era. However, it may be difficult for USPS to expand its performance management system for managers and supervisors to the majority of its employees. Most postal employees are craft employees who transport, process, and deliver mail and who are represented by unions. Postal managers and unions have repeatedly disagreed over whether to implement some form of performance-based compensation and incentive system for craft workers.

Another area of disagreement involves the appropriate level of compensation and benefits for postal employees. USPS and its major labor unions have often disagreed with how the comparability standard established by law to pay compensation and benefits comparable to those in the private sector should be applied. For example, the Supplemental Opinion for the 2000 National Agreement between USPS and the American Postal Workers Union (APWU) noted the following:

"The evidence relating to private sector comparability is both voluminous and contradictory. . . . When all is said and done, however, what stands out clearly, divorced from all the competing multivariate regression analyses and job content analyses, is that Postal Service jobs are highly sought after, and once obtained, are held onto. Applicant queues are long, and the quit rate is all but non-existent. . . . These data, which show how much Postal Service jobs are valued, both by those who want them and by those who have them, provide powerful support for the Postal Service argument that the Postal Service provides a wage and benefit package to APWU represented employees that is better than that available for comparable work in the private sector."

Compensation and benefit disputes have often been resolved in binding arbitration, and union and postal officials have different views on third-party binding arbitration. Union officials believe that because they are not allowed to strike, they need third-party binding arbitration to resolve contested labor-management issues. Postal officials believe that the binding arbitration mechanism presents a number of challenges, because a third party is not accountable for finding revenues or cost savings to fund increases in wages or benefits.

For transformation to be successful, it is vital for USPS and its unions to share a common vision for the future and a mutual responsibility for

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finding solutions to USPS's financial and workforce problems. USPS's transformation process can provide an opportunity for postal labor and management to move beyond past problems and redefine a future in which they can mutually address the financial and workforce challenges of transforming USPS.

Process of Achieving Postal Transformation

Strong and proactive leadership by USPS's Board of Governors and its executives will be essential to transforming this organization so it can fulfill its mission and remain financially viable. As a first step, USPS's leaders need to provide a vision of USPS's future in its transformation plan and actively engage with its employees and the divided community of postal stakeholders to achieve the necessary consensus to move forward. In addition, it is urgent for USPS to take aggressive action to address its financial situation. In the short term, one possibility would be to determine what rate increases would be needed to generate sufficient revenue to cover costs, address unmet capital needs, and reduce debt. Further, USPS should aggressively continue efforts to cut costs and improve productivity in the short term as well as identify more comprehensive efforts that would be part of its structural transformation. In the end, congressional action will be required for a successful postal transformation.

The process of transformation should include these three steps:

1. Determine what can be accomplished within current law and what the constraints are to making progress.

2. Determine what interim legislative changes may be needed immediately to deal with USPS's financial problems, and whether these interim changes are compatible with desired long-term changes.

3. Determine what comprehensive changes are needed and work with Congress and postal stakeholders to enact these changes into law.

To implement these steps, sustained and aggressive leadership is needed to overcome the organization's natural resistance to change. USPS's Board of Governors, its managers, leaders of employee unions and management associations, and customers have the opportunity to work together for change. USPS strategies for change need to be aligned with USPS's mission and role; support its financial viability; and deal with key areas, such as productivity, infrastructure, performance management and workforce issues, and employee support. Active communication throughout the
organization and with Congress, stakeholders, and the public is essential to inform and educate people about the need for change, potential benefits for those involved, and how their interests will be protected. Involving employees in developing and implementing these steps toward transformation could foster their acceptance and instill a sense of ownership in the new organization.

In addition, key public policy, structural, and financial issues need to be resolved. Over the past 7 years, Congress has held numerous hearings on postal reform issues and considered numerous proposals for changing the nation's postal laws, but none of the proposed bills have been enacted. To date, a consensus on legislative action has been difficult to achieve among the divided stakeholder community. Further, although comprehensive postal reform proposals have been offered that address many of the key public policy, structural, and financial issues we have discussed in this report, these proposals did not fully address legal requirements and practical constraints in the areas of USPS's infrastructure and workforce. Congress needs to reassess USPS's legal framework and take the necessary action to change the nation's postal laws in order for USPS to be financially viable in the 21st century.

One of the areas where consensus has been difficult to achieve relates to the issue of how much and what type of infrastructure USPS needs to get the job done. Recognizing the difficulty and sensitivity of addressing this issue, particularly when it involves closing and consolidating postal facilities, Congress could establish a process similar to that used for closing military bases. Under this process, Congress could affirm a proposed package of closures and consolidations with an up-or-down vote. Such a process could be analogous to the military base-closure process that has been used in the past. Military base-closing legislation enacted in 1988 and 1990, including the Defense Base Closure and Realignment Act of 1990 (P.L. 101-510), was enacted to overcome public concern about the economic effects of closures on communities and the perceived lack of impartiality of the decision-making process. This legislation provided the basis for four rounds of base realignments and closures between 1988 and 1995, the closure of 97 out of 495 major domestic military installations, many smaller base closings, and the realignment of other facilities.
USPS's Response to Our Past Recommendations

Transparency, along with accurate and timely financial reports, is vital to ensure public confidence. In April 2001, we recommended that USPS develop a transformation plan and institute quarterly financial reporting to improve transparency. USPS agreed with these recommendations and is working to implement them.

USPS Transformation Plan

In response to our recommendation that USPS develop a transformation plan, last fall USPS published a draft outline of its forthcoming transformation plan; called for public comments in the Federal Register; and is working to finalize this plan by March 31, 2002. Given the urgency of USPS's financial situation and the lengthy time it will take to implement fundamental structural changes, the stakeholder community is looking to USPS for leadership in presenting its vision for the future in its transformation plan. At this juncture, USPS's Board of Governors and postal management have the opportunity to make the case for a comprehensive transformation in USPS's forthcoming transformation plan as well as by other means, and to provide a vision for its future, followed by options and strategies for change. USPS also could suggest ways to achieve the necessary consensus for change among Congress, stakeholders, and the public.

Quarterly Financial Reporting and Transparency

During fiscal year 2001, USPS made numerous revisions to its financial outlook for the fiscal year with little or no public explanation, creating confusion and raising concerns about its ability to generate timely and reliable financial information. It was unclear to many stakeholders why USPS's financial outlook changed from a $480 million deficit in its fiscal year 2001 budget approved in November 2000 to a projected $2 billion to $3 billion deficit in February 2001. We reported that greater transparency is needed regarding USPS's financial and operating results and projections. To this end, we recommended that USPS implement quarterly financial reporting; and in response, USPS published on its Web site a quarterly financial report for the third quarter of fiscal year 2001. This report was a good starting point for providing information to Congress and the public; and we expect it to improve over time. However, opportunities for improving the timeliness and accessibility of USPS financial data remain.

- Although USPS issued its annual financial statement for fiscal year 2001 in December 2001, as of mid-February 2002, USPS had not published
quarterly financial reports for the fourth quarter of fiscal year 2001 or the first quarter of fiscal year 2002.22

• From October 2001 to mid-January 2002, USPS had not publicly released its financial and operating statements for the last accounting period of fiscal year 2001 and the first three accounting periods of fiscal year 2002 until January 2002. These reports contain preliminary financial results and other information such as workforce-related information. These reports have not been available to the public on USPS’s Web site; however, USPS’s Chief Financial Officer told us that he planned on posting future accounting period reports to USPS’s Web site.

During the fall of 2001, when USPS experienced sharp declines in its mail volumes and revenues and requested additional appropriations from Congress, readily available and detailed information on USPS’s changing financial situation was scarce. More timely availability of monthly and quarterly reports, even if they contain preliminary data subject to revision, would be useful to improve transparency for congressional oversight, the stakeholder community, and the public.

Conclusions

USPS’s basic business model is not sustainable. USPS finances are deteriorating as rates, costs, and debt spiral upward; and its liabilities exceed its assets and are increasing. USPS’s mail volume is starting to decline, and much larger declines may be in the offing as mailers shift to electronic and other delivery alternatives. Further, USPS has long-standing and continuing difficulties with cutting costs and achieving and sustaining productivity gains. USPS is working to make progress in these areas, but it is limited by legal requirements and practical constraints.

Tinkering with the existing system will be insufficient to produce a comprehensive transformation that will enable USPS to fulfill its mission in the 21st century. If structural issues are not addressed, we believe a crisis will develop to the point when options for action will be more limited and costly. As the incidents of anthrax in the mail indicated, disruptions in mail

22 USPS has a long-standing practice of withholding detailed financial information on the fourth quarter of a fiscal year and the first accounting periods of the following fiscal year until its annual financial statements have been audited and approved by the Board of Governors. The board approved USPS’s audited financial statements for fiscal year 2001 in December 2001.
delivery service can have far-reaching consequences for the government, households, businesses, and the general economy. On the positive side, a window of opportunity is available for a comprehensive transformation. For example, the wave of impending retirements could enable USPS to restructure its infrastructure and workforce without large-scale layoffs.

Some progress is possible within the current structure and is urgently needed. For example, USPS can take additional actions to cut costs and improve productivity under its existing authority and identify incremental legislative changes that are needed to help address its financial situation. However, a comprehensive postal transformation will be required to fully address USPS's financial viability and the statutory framework under which USPS operates. This framework includes USPS's mission and role in the 21st century, the postal monopoly, the break-even mandate, the statutory monopoly on letter mail, and the cost-of-service rate-setting process. In addition, transformation efforts have been limited by legal requirements and practical constraints relating to closing and consolidating postal facilities and realigning the postal workforce.

Although various legislative postal reform proposals have been developed over the last several years that address many key transformation issues, they did not directly address such issues as USPS's infrastructure and workforce. Congress has not enacted any of these proposals, as consensus among the stakeholders has been difficult to achieve. It is clear to us that strong leadership from USPS will be necessary to help convince Congress and postal stakeholders that change is needed. Further, USPS's forthcoming transformation plan could provide an opportunity for USPS to explain to Congress and postal stakeholders the need for change, the actions USPS plans to take under its existing authority, and the types of legislative changes and support it believes are necessary to improve its financial viability and achieve a successful transformation. In addition, USPS can further improve the transparency of its financial information by making it available in a more timely and user-friendly manner.

Congress has a number of options for how it could address postal reform and transformation. It could use the traditional hearings process to discuss the need for and types of changes necessary and enact incremental legislative changes aimed at helping USPS deal with its financial situation. It could also establish a mechanism similar to the military base-closure process that has been used in the past to consider issues, such as closure or consolidation of some postal facilities. In addition, a commission could be established that could prepare a proposal for addressing unresolved
transformation issues. Such issues could include USPS's mission and role and break-even mandate, the postal monopoly, public/private provision of postal services, competition, USPS governance and accountability, infrastructure, workforce, and debt.

Matter for Congressional Consideration

Regardless of the process Congress chooses to deal with postal reform, we believe that USPS's worsening financial situation and outlook intensify the need for Congress to act on meaningful postal reform and transformation legislation. Accordingly, we suggest that Congress consider and promptly act on incremental legislative changes that could help USPS deal with its financial situation soon after it receives USPS's transformation plan. In addition, comprehensive legislative changes will be needed to address key unresolved transformation issues. Congress could consider how best to address such issues, such as infrastructure and workforce issues that may require input from a variety of stakeholders and will involve some shared sacrifice. One option may be to create a commission to address the unresolved issues and develop a comprehensive proposal for consideration by Congress.

Recommendations for Executive Action

In view of the severity of USPS's financial situation, we recommend that USPS's Board of Governors and the PMG provide proactive leadership for transformation by informing Congress and the public of the need for change in its transformation plan and by other means and by working with Congress and stakeholders in developing and implementing strategies for action. These strategies should include (1) actions that USPS can take within its current authority, (2) specific congressional actions that would enable USPS to take a number of incremental steps to address its growing financial and operational challenges, and (3) a process to address a range of comprehensive legislative reforms that will be needed to address key unresolved transformation issues. In addition, we recommend that USPS improve the transparency of its financial data by providing monthly and quarterly financial reports in a user-friendly format on its Web site in a more timely manner.

Agency Comments and Our Evaluation

USPS provided comments on a draft of this report in a letter from the PMG dated February 20, 2002. These comments are summarized below and reproduced in appendix II. In commenting on a draft of our report, the PMG stated that the Service realizes the challenges it faces and is fully
committed to meeting them. He said that USPS has begun work on a comprehensive transformation plan, which is due to be completed by the end of March 2002. Further, he agreed with our recommendations and stated that USPS plans to inform Congress and the public of the need for change in its transformation plan and by other means. In addition, he stated that USPS intends to work with Congress and all stakeholders in developing and implementing strategies for action. He also agreed with our recommendation to improve the transparency of USPS's financial data. He said that USPS is already providing financial reports on its Web site in a more timely and user-friendly fashion.

The PMG also commented that USPS has met the challenge of increasing its productivity despite significant investments in improving the quality of customer service, which its productivity measure gives it no credit for, and engaging in significant worksharing programs that transfer prime opportunities for productivity gains to the mailers. He also noted that USPS continues to take issue with comparisons between USPS and economywide productivity measures.

As we stated in our report, although USPS has made recent productivity gains, it has had difficulty increasing and sustaining long-term productivity growth. In fiscal years 2000 and 2001, USPS's productivity rose 3.6 percent, but its productivity increased only 11.5 percent over the past 3 decades. Further, postal productivity decreased 0.7 percent from fiscal years 1990 to 1999, despite billions of dollars invested in automation and information technology over that period. To achieve real savings and productivity improvement, USPS would need to decrease unneeded capacity resulting from efficiency gains and increase capacity only where such an increase is needed.

In regard to USPS's point that its productivity measure does not address quality, we recognize that organizations should have a variety of measures to gauge their performance, including quality, timeliness, customer satisfaction, and cost and productivity; and that more than one measure should be looked at when assessing USPS's overall performance. This does not, however, diminish the importance of measuring USPS's productivity, which USPS itself has used as a performance measure for many years and as one of the factors that has been considered in its pay-for-performance program for its executives, managers, and supervisors. Similarly, in our view, the fact that USPS has engaged in worksharing programs does not diminish the need for and importance of USPS's progress in improving the productivity of its operations. Finally, neither our draft nor final reports
compared USPS's productivity with economywide productivity measures. However, we note that USPS itself made such a comparison in its 1999 and 2000 annual reports. In these reports, USPS compared its Total Factor Productivity with Multifactor Productivity—a productivity measure used by the Bureau of Labor Statistics for the nonfarm business sector of the economy.

As arranged with your offices, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days after the date of this report. At that time, we will send copies of this report to the chairman and ranking minority member of the House Committee on Government Reform, chairmen and ranking minority members of the House and Senate Committees on Appropriations, USPS's postmaster general/chief executive officer, USPS's chief financial officer, the chairman of the Postal Rate Commission, and other interested parties. We will also make copies available to others on request.

Staff acknowledgments are included in appendix III. If you have any questions about this report, please contact me on (202) 512-8387 or at ungarb@gao.gov.

Bernard L. Ungar
Director, Physical Infrastructure Issues
The U.S. Postal Service's (USPS) net loss of $1.68 billion in fiscal year 2001 marked its 6th consecutive year of declining net income and its 2nd consecutive year of losses. USPS's financial outlook changed repeatedly during fiscal year 2001—from a $480 million deficit in its budget approved in November 2000 to a $2 billion to $3 billion deficit in February 2001—to successively lower estimates near the end of the fiscal year. According to USPS officials, a number of factors listed below contributed to a deficit larger than what was included in USPS's originally approved budget (see table 6). However, these factors were partially offset by costs that were lower than budgeted by USPS, partly due to work-hour reductions and cost-saving initiatives later in the year.

- A slowing economy resulted in lower than budgeted volumes and revenues.

- Some postal rate increases were implemented later than expected, resulting in less revenues than budgeted by USPS.

- The diversion of First-Class Mail and, to a lesser extent, Standard Mail (primarily advertising), to electronic communications and payment alternatives depressed mail volume.

- Mail volume and revenue declined following the September terrorist attacks.

- New products and services did not generate expected revenues, particularly in the area of electronic commerce. (USPS budgeted $104 million for e-commerce revenues, but actual e-commerce revenues were about $2 million.)

- Expenses increased at twice the rate of revenues (4.2 percent v. 2.0 percent).
Table 6: Fiscal Year 2001 Budgeted Versus Actual Financial Results

<table>
<thead>
<tr>
<th>Area</th>
<th>Actual</th>
<th>Budgeted</th>
<th>Variance of actual from budgeted</th>
<th>Percentage variance</th>
<th>Percentage change from same period last year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>$65,869</td>
<td>$67,925</td>
<td>($2,056)</td>
<td>(3.0%)</td>
<td>2.0%</td>
</tr>
<tr>
<td>Expense</td>
<td>$67,549</td>
<td>$68,405</td>
<td>($856)</td>
<td>(1.3%)</td>
<td>4.2</td>
</tr>
<tr>
<td>Net income</td>
<td>($1,680)</td>
<td>($480)</td>
<td>($1,200)</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Mail volumes</td>
<td>207,463</td>
<td>207,721</td>
<td>(258)</td>
<td>(0.1%)</td>
<td>(0.2%)</td>
</tr>
</tbody>
</table>

Note 1: N/A indicates that USPS does not calculate these data.
Note 2: Negative numbers are in parentheses.
Source: USPS financial and mail volume data.

Figures 7 through 9 illustrate USPS's net income, revenue, and mail volumes for fiscal year 2001.
Figure 7: USPS's Net Income for Fiscal Year 2001

Source: USPS financial data.
Appendix I
Fiscal Year 2001 Results

Figure 8: Fiscal Year 2001 Revenues Compared with Budgeted Levels

Source: USPS financial data.
Figure 9: Fiscal Year 2001 Mail Volumes Compared with Budgeted Levels

Source: USPS data.

Table 7 shows trends in key financial indicators for a 30-year period as reported by USPS, such as net income (loss), appropriations for public service costs and other operations, outstanding debt, accumulated deficits, capital cash outlays, and retirement-related costs.
## Table 7: Selected Financial Results, Fiscal Years 1972 through 2001

<table>
<thead>
<tr>
<th>Fiscal year</th>
<th>Net income (loss)</th>
<th>For public service costs</th>
<th>Other appropriations</th>
<th>Outstanding debt</th>
<th>Accumulated deficit balance</th>
<th>Capital cash outlays</th>
<th>Retirement-related costs</th>
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<tbody>
<tr>
<td>1972</td>
<td>($175)</td>
<td>920</td>
<td>504</td>
<td>250</td>
<td>($175)</td>
<td>331</td>
<td>446</td>
</tr>
<tr>
<td>1973</td>
<td>(13)</td>
<td>920</td>
<td>566</td>
<td>250</td>
<td>(188)</td>
<td>363</td>
<td>560</td>
</tr>
<tr>
<td>1974</td>
<td>(439)</td>
<td>920</td>
<td>830</td>
<td>765</td>
<td>(627)</td>
<td>696</td>
<td>700</td>
</tr>
<tr>
<td>1975</td>
<td>(989)</td>
<td>920</td>
<td>613</td>
<td>1,783</td>
<td>(1,616)</td>
<td>728</td>
<td>752</td>
</tr>
<tr>
<td>1976</td>
<td>(1,176)</td>
<td>920</td>
<td>725</td>
<td>3,030</td>
<td>(2,791)</td>
<td>673</td>
<td>1,003</td>
</tr>
<tr>
<td>1976 TQ^a</td>
<td>15</td>
<td>230</td>
<td>189</td>
<td>3,530</td>
<td>(2,776)</td>
<td>122</td>
<td>251</td>
</tr>
<tr>
<td>1977</td>
<td>(687)</td>
<td>920</td>
<td>792</td>
<td>2,468</td>
<td>(3,646)</td>
<td>419</td>
<td>1,076</td>
</tr>
<tr>
<td>1978</td>
<td>(380)</td>
<td>920</td>
<td>802</td>
<td>2,405</td>
<td>(3,843)</td>
<td>336</td>
<td>1,178</td>
</tr>
<tr>
<td>1979</td>
<td>470</td>
<td>920</td>
<td>800</td>
<td>1,888</td>
<td>(3,374)</td>
<td>387</td>
<td>1,405</td>
</tr>
<tr>
<td>1980</td>
<td>(306)</td>
<td>828</td>
<td>782</td>
<td>1,841</td>
<td>(3,880)</td>
<td>371</td>
<td>1,457</td>
</tr>
<tr>
<td>1981</td>
<td>(588)</td>
<td>486</td>
<td>789</td>
<td>1,608</td>
<td>(4,268)</td>
<td>499</td>
<td>1,539</td>
</tr>
<tr>
<td>1982</td>
<td>802</td>
<td>12</td>
<td>695</td>
<td>1,536</td>
<td>(3,466)</td>
<td>436</td>
<td>1,720</td>
</tr>
<tr>
<td>1983</td>
<td>616</td>
<td>0</td>
<td>789</td>
<td>1,464</td>
<td>(2,850)</td>
<td>600</td>
<td>1,864</td>
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<tr>
<td>1984</td>
<td>118</td>
<td>0</td>
<td>879</td>
<td>1,465</td>
<td>(2,732)</td>
<td>860</td>
<td>1,647</td>
</tr>
<tr>
<td>1985</td>
<td>(251)</td>
<td>0</td>
<td>970</td>
<td>2,075</td>
<td>(2,984)</td>
<td>997</td>
<td>2,260</td>
</tr>
<tr>
<td>1986</td>
<td>304</td>
<td>0</td>
<td>716</td>
<td>3,234</td>
<td>(2,679)</td>
<td>1,247</td>
<td>2,360</td>
</tr>
<tr>
<td>1987</td>
<td>(223)</td>
<td>0</td>
<td>650</td>
<td>4,728</td>
<td>(2,902)</td>
<td>1,664</td>
<td>3,225</td>
</tr>
<tr>
<td>1988</td>
<td>(597)</td>
<td>0</td>
<td>517</td>
<td>5,880</td>
<td>(3,499)</td>
<td>1,708</td>
<td>4,186</td>
</tr>
<tr>
<td>1989</td>
<td>61</td>
<td>0</td>
<td>436</td>
<td>6,476</td>
<td>(3,438)</td>
<td>1,400</td>
<td>4,474</td>
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<tr>
<td>1990</td>
<td>(874)</td>
<td>0</td>
<td>453</td>
<td>6,971</td>
<td>(4,312)</td>
<td>1,858</td>
<td>3,962</td>
</tr>
<tr>
<td>1991</td>
<td>(1,469)</td>
<td>0</td>
<td>562</td>
<td>8,440</td>
<td>(5,760)</td>
<td>2,321</td>
<td>6,625</td>
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<tr>
<td>1992</td>
<td>(536)</td>
<td>0</td>
<td>545</td>
<td>9,924</td>
<td>(6,317)</td>
<td>2,454</td>
<td>5,931</td>
</tr>
<tr>
<td>1993</td>
<td>(1,765)</td>
<td>0</td>
<td>164</td>
<td>9,748</td>
<td>(8,082)</td>
<td>1,819</td>
<td>7,068</td>
</tr>
<tr>
<td>1994</td>
<td>(914)</td>
<td>0</td>
<td>160</td>
<td>8,988</td>
<td>(8,995)</td>
<td>1,722</td>
<td>6,616</td>
</tr>
<tr>
<td>1995</td>
<td>1,770</td>
<td>0</td>
<td>146</td>
<td>7,280</td>
<td>(7,225)</td>
<td>1,795</td>
<td>6,970</td>
</tr>
<tr>
<td>1996</td>
<td>1,567</td>
<td>0</td>
<td>122</td>
<td>5,919</td>
<td>(5,658)</td>
<td>2,336</td>
<td>7,614</td>
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<td>1997</td>
<td>1,264</td>
<td>0</td>
<td>112</td>
<td>5,872</td>
<td>(4,394)</td>
<td>3,207</td>
<td>8,003</td>
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<tr>
<td>1998</td>
<td>550</td>
<td>0</td>
<td>96</td>
<td>6,421</td>
<td>(3,844)</td>
<td>3,006</td>
<td>8,279</td>
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<tr>
<td>1999</td>
<td>363</td>
<td>0</td>
<td>100</td>
<td>6,917</td>
<td>(3,481)</td>
<td>3,788</td>
<td>8,694</td>
</tr>
<tr>
<td>2000</td>
<td>(199)</td>
<td>0</td>
<td>93</td>
<td>9,316</td>
<td>(3,680)</td>
<td>3,254</td>
<td>9,273</td>
</tr>
<tr>
<td>2001</td>
<td>(1,880)</td>
<td>0</td>
<td>96</td>
<td>11,315</td>
<td>(5,360)</td>
<td>2,932</td>
<td>9,743</td>
</tr>
</tbody>
</table>

Note: Negative numbers are in parentheses.
Appendix I
Fiscal Year 2001 Results

*The Postal Reorganization Act provides an authorization for appropriations as reimbursement to USPS for public service costs incurred by it in providing a maximum degree of effective and regular postal service nationwide, in communities where post offices may not be deemed self-sustaining. See 39 U.S.C. § 2401(b).

*Appropriations during this period were principally for revenue forgone for free and reduced rate mail. These figures represent appropriations that were recorded in USPS’s operating statements.

*Capital cash outlays consist of the purchase of property and equipment, net of the proceeds from the sale of property and equipment.

*Retirement-related costs consist of the following expense categories: retirement, retiree health benefits, related interest, and Omnibus Budget and Reconciliation Act adjustments.

*TQ represents transition quarter, a period beginning July 1, 1976, and ending September 30, 1976. In a change taking effect October 1, 1976, the U.S. government changed its fiscal year from a period ending June 30 to a period beginning each October 1 and ending the following September 30.

Source: USPS financial data.
February 20, 2002

Mr. Bernard L. Ungar
Director, Physical Infrastructure Issues
United States General Accounting Office
Washington, DC 20548-0001

Dear Mr. Ungar:

Thank you for providing the Postal Service with an opportunity to review and comment on the draft report entitled, U.S. Postal Service: Deteriorating Financial Outlook Increases Need for Transformation, a follow-up to earlier work concerning the Postal Service's transformation efforts and long-term outlook.

We appreciate your grasp of the issues facing the Postal Service in our efforts to provide universal service at affordable rates. This has been a particularly difficult challenge in light of recent economic conditions, the aftermath of September 11 as well as anthrax in the mail. As your report indicates, even in the absence of recent events, the Postal Service faces a variety of legal and practical constraints that must be overcome in order to make many of the changes that must be made.

We are aware that continuing rate increases are not the solution to our problem. We must find ways of generating new revenues, while continuing to reduce costs. We believe, however, that we have made progress, as evidenced by productivity growth and reduced employment (30,000 fewer career employees in the past two and one-half years). We should note that we continue to take issue with comparisons between Postal Service and economy-wide productivity measures. The Postal Service operates in the service sector and is labor-intensive. Further, the Postal Service engages in significant worksharing programs that over the years have transferred prime opportunities for productivity gains to the private sector. Moreover, the Postal Service has made significant investments since the Postal Reorganization was implemented in 1971 to improve the quality of customer service. The Total Factor Productivity measure gives no credit for these improvements. I believe we have met the challenge of increasing productivity despite these issues.

We fully agree with the recommendation in your report of the need to inform Congress and the public of the need for postal change. Our Transformation Plan and related activities will do that. We intend to work with Congress and all stakeholders in developing and implementing strategies for action. Our Transformation Plan will outline strategies that the Postal Service can follow under its current authority and will specify congressional actions that would empower the Postal Service to take incremental steps to address financial and operational issues. Finally, the plan will present a range of alternative business models that may better address the long-term viability of the national postal system.
Appendix II
Comments from the U.S. Postal Service

-2-

We also agree with the recommendation that we improve the transparency of our financial data, and we already are providing financial reports on our website in a more timely and user-friendly fashion.

If you or your staff would like to discuss any of these comments further, I am available at your convenience.

Sincerely,

[Signature]

John E. Potter
Appendix III

GAO Contacts and Staff Acknowledgments

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**GAO Contact**

Bernard L. Ungar (202) 512-8387

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**Acknowledgments**

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