Testimony of

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On behalf of the

Postal Regulatory Commission

Before the

U.S. House Oversight & Government Reform Committee

May 11, 2016

Introduction

Chairman Chaffetz, Ranking Member Cummings, and members of the Committee on Oversight and Government Reform, good morning. My name is Robert G. Taub. I am the Acting Chairman of the Postal Regulatory Commission (Commission). I am pleased to testify before you today.

Background

The Commission is an independent federal agency that is responsible for ensuring transparency and accountability of the U.S. Postal Service's operations and finances. Today, the Postal Service is a $69 billion operation with more than 600,000 employees. It is not quasi government, quasi private, or quasi anything – it is 100 percent part of the Federal Government, operating as an independent establishment in the Executive Branch. Yet the Postal Service receives no tax dollars for operating expenses and relies completely on the sale of postage, products, and services to fund its operations.

As a separate and independent federal regulatory agency, the Postal Regulatory Commission determines the legality of the Postal Service's prices and products, adjudicates complaints and fair competition issues, and oversees the Postal Service's delivery performance consistent with statutory requirements. Its mission is to ensure transparency and accountability of the Postal Service and foster a vital and efficient universal mail system. The Commission is the regulator, not the operator of our nation's Postal Service – we do not manage the Postal Service, we regulate it. The Commission is composed of five Commissioners, each appointed by the President and confirmed by the Senate. The Commission receives an annual appropriation from Congress out of the Postal Service Fund.

Why a regulator for another government agency? Unlike almost any other federal agency, the Postal Service operates in a commercial marketplace while also having a large contingent of captive customers given the Postal Service’s market dominance for certain products and services. The Postal Service is provided a statutory monopoly over mailboxes and the delivery of letters. The public interest role of a regulator in this case is clear: a need to protect the captive customers and ensure fair competition.

The Commission carries out this work with a very small budget and staff. Its current year appropriation is $15.2 million to regulate the $69 billion Postal Service. The David and Goliath analogy is sometimes apt. Despite a steadily increasing workload, until this year, the Commission's annual appropriation had always been less than what it received in Fiscal Year (FY) 2008. FY 2008 was the last year that the Commission received its funds directly from the Postal Service rather than through the appropriations process. The Commission’s budget in FY 2008 was $14.985 million for an authorized complement of 70 employees; 7 years later, the Commission's appropriation in FY 2015 was $14.7 million for an employee complement of 77. The majority of the Commission’s FY 2015 budget was allocated to pay and benefits ($11.175 million) with the remainder allocated for operating expenses ($3.525 million). In order to accommodate the increasing cost of personnel benefits and operating expenses, the Commission has had to defer hiring and delay many critical Information Technology-related projects. This path is no longer sustainable for the Commission given existing government-wide information security requirements as well as an increasing regulatory workload.

PRC Focus on USPS Financing

Commission rules require the Postal Service to file several reports with the Commission regarding financial results on a monthly, quarterly, and annual basis. The Commission staff internally analyzes these reports. Prior to 2014, the Commission's *Annual Compliance Determination* (ACD) included a chapter on the overall financial health of the Postal Service. However, because the ACD is focused on rates and service performance, it did not include a detailed analysis of other financial data provided in the Postal Service's *Annual Compliance Report* as well as its Securities and Exchange Commission equivalent Form 10-K filing. In 2014, the Commission developed a separate *Financial Analysis* report to provide greater clarity and transparency of the Postal Service's financial data and trends.

This year, the Commission published its third annual *Financial Analysis* report which not only reviews the overall financial position of the Postal Service, but also analyzes volumes, revenues, and costs of both Market Dominant and Competitive products. The report includes a chapter that analyzes the Postal Service's financial status in terms of profitability, solvency, activity, and financial stability using accounting ratios. I would like to highlight our observations and conclusions from the Commission's FY 2015 *Financial Analysis* report.

Overview of USPS Finances: Liabilities Outstrip Assets Resulting in Low Liquidity

In FY 2015, the Postal Service had a total net loss of $5.1 billion, which is a $447 million improvement from FY 2014. However, this is the ninth consecutive net loss posted since FY 2007 and has increased the cumulative net deficit since FY 2007 to

$56.8 billion. As noted in the FY 2015 *Financial Analysis* report, these continuing losses have significantly affected the financial position of the Postal Service by negatively impacting liquidity, requiring the Postal Service to use all of its $15 billion statutory borrowing capacity, and causing total net liabilities to far exceed total net assets.

Total revenue increased $1.1 billion in FY 2015 primarily due to an increase in Competitive product volumes and the Market Dominant exigent surcharge.[1] Total volume declined by almost 1 percent, or 1.4 billion pieces, with Market Dominant products accounting for all of the volume loss. Despite the loss of Market Dominant volume, total revenue for Market Dominant products was slightly higher than last year. The exigent surcharge added $2.1 billion in revenue, which was enough to offset the loss of revenue due to declining volumes. Competitive product volumes continued to increase significantly in FY 2015, growing 16.3 percent over last year. This increased volume added approximately $1.3 billion in revenue. Other non-mail related revenues, which include gains/losses on disposal of property and equipment, philately, and other non-mail related revenues, declined $0.4 billion.

Total expenses increased $0.6 billion in FY 2015. This overall increase reflected an increase of $1.5 billion in compensation and benefits costs and a decrease in workers' compensation liability of $0.9 billion. An increase in workhours (the first since FY 2005) and the number of career employees (the first since FY 1999) increased compensation expenses by $0.8 billion. Retirement expenses also increased due to an increase in the Federal Employee Retirement System (FERS) annuity rate from 11.9

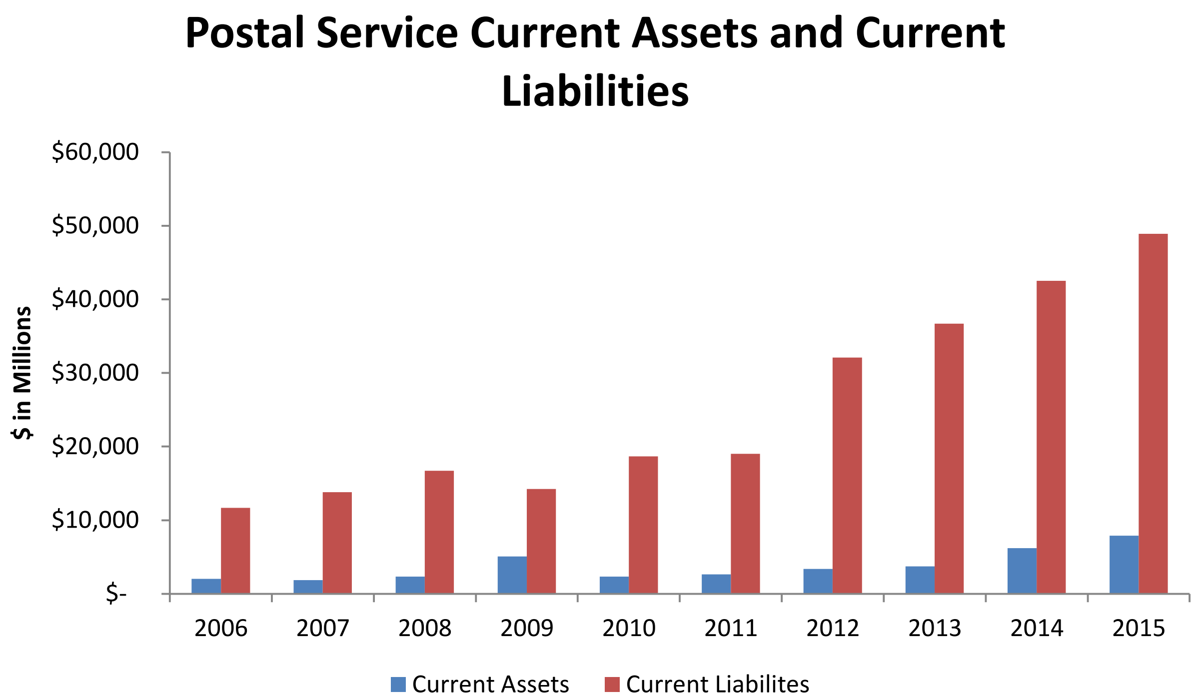
[1] This surcharge was permitted by the Commission after it found that the Postal Service had justified the recovery of additional contribution by showing a causal link between the extraordinary or exceptional circumstances of the Great Recession and mail volume losses.

percent of base pay to 13.2 percent of base pay and a supplemental payment to the FERS fund. Other benefits costs such as the current year premiums for retiree health benefits and the payment to the Department of Labor for workers' compensation costs also contributed to the increase in compensation and benefits. Further data on personnel related costs are detailed later in this testimony.

The $0.9 billion decrease in workers' compensation liability was due to actuarial changes in the development of the estimate and changes in the discount rate. Non-personnel expenses, including transportation, also declined in FY 2015.

In the face of financial losses, over the past 8 years, the Postal Service has reduced the size of its workforce by about 200,000 career employees, cut labor related costs, and increased its productivity. Today the Postal Service delivers roughly the same volume of mail that it delivered in 1987, but with almost 168,000 fewer total employees. Yet even with these sizeable reductions, the Postal Service does not have the cash to pay down its debt or fully invest much needed capital in its operations.

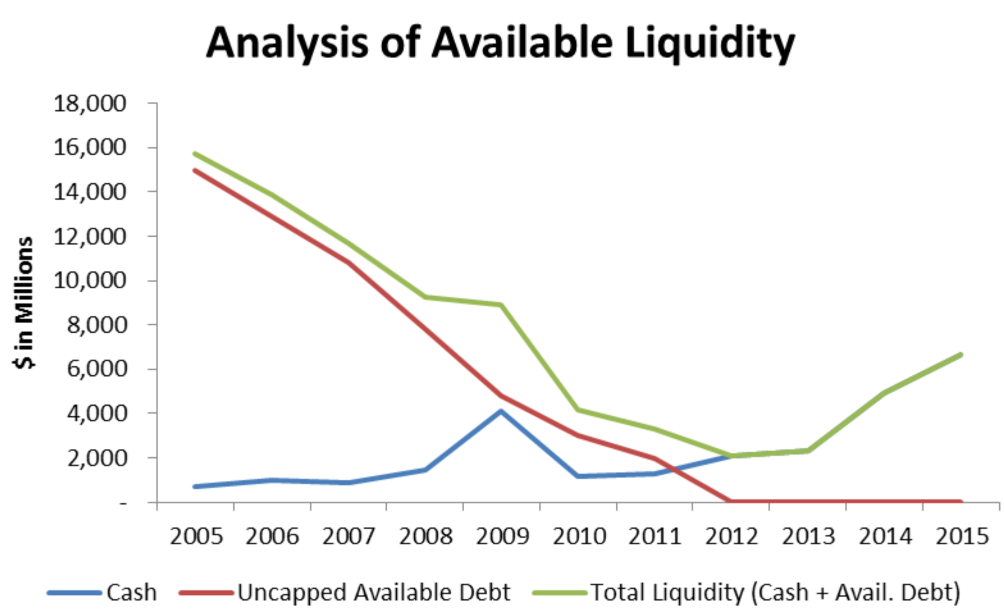
The significant gap between the Postal Service's net current assets and net current liabilities is of particular concern. As noted in the FY 2015 *Financial Analysis* report, the Commission found that despite a slight improvement in liquidity, current assets, consisting mostly of cash and cash equivalents, continued to be insufficient to meet the payment of current liabilities.



In FY 2015, total current liquid assets increased by $1.7 billion from FY 2014; however, the amount of current liabilities rose by $6.3 billion, worsening the overall financial situation. Most of the increase in the current liabilities is due to the fact that the Postal Service did not make the $5.7 billion statutorily required FY 2015 payment to the Postal Service Retiree Health Benefits Fund (PSRHBF). The total net current assets were $7.9 billion at the end of FY 2015, of which $6.9 billion was cash and cash equivalents. Net current liabilities at the end of this fiscal year were $48.9 billion, which included $28.1 billion in missed payments to the PSRHBF (the payments scheduled for FY 2011 through FY 2015). Also included in net current liabilities is $10.1 billion of the total $15 billion owed to the Federal Financing Bank. Further data on the PSRHBF are detailed later in this testimony in the additional information on personnel related costs.

These low liquidity levels in recent years have impeded the Postal Service's ability to make capital investments in infrastructure and hindered the growth and productivity enhancements in key assets required for primary postal operations. As the Postal Service noted in the FY 2015 Form 10-K statement, it now operates an aging vehicle fleet, increasing the need, and consequently the cost, for maintenance and repair. Also unmet is the need to invest in sorting and handling equipment to fully capitalize on business opportunities in the growing package delivery markets.

According to the Postal Service's FY 2015 Form 10-K statement, "If our operations do not generate the liquidity we require, we may be forced to reduce, delay or cancel investments in technology, facilities, and/or transportation equipment, as we have done in the recent past…. Additionally, our aging facilities, equipment and transportation fleet could inhibit our ability to be competitive in the marketplace, deliver a high-quality service and meet the needs of the American public…. An aging or potentially obsolete infrastructure could result in loss of business and increased costs."



On an *operational* basis the Postal Service's net income (i.e., before including the statutory prefunding accruals to the PSRHBF and any non-cash adjustments to workers' compensation liability) is $1.2 billion. Most of this operational net income can be attributed to an increase in revenues from the exigent price surcharge on Market Dominant products and the continuing growth in Competitive products parcels. The exigent surcharge, effective for the full fiscal year, increased revenue by an estimated $2.1 billion, offsetting all of the revenue loss from the declining Market Dominant volume. The temporary surcharge was removed on April 10, 2016.

The increase in operating net income enabled the Postal Service to improve its liquidity position. Compared to FY 2014, the Postal Service increased its cash position by $1.7 billion. This increase in cash enables the Postal Service to begin planning for replacement of its capital assets, primarily delivery vehicles and package sorting equipment. Yet, as noted, this increase is overshadowed by the increase in current liabilities, primarily due to the inability of the Postal Service to make the statutorily required pre-funding payments into the PSRHBF. Overall, according to the Postal Service, it has approximately 24 days of cash available to pay basic operating expenses. This consists only of available cash as the Postal Service has reached the statutory borrowing limit. The current level of Postal Service reported liquidity has improved since its low point in FY 2012, but total cash on hand plus total debt is only a third of what was available 10 years ago.

If a downturn in the economy or other circumstance should further stress the Postal Service's cash flow, it risks not being able to pay some of its bills and could, in a worst case scenario, run out of cash.

Analyzing Postal Service Financial Status: Profitability, Solvency, Activity, and Financial Stability

The Commission's *Financial Analysis* report uses "ratio analysis" to measure the profitability, solvency, and financial stability of the Postal Service. As detailed in the Commission's *Financial Analysis* reports, ratio analysis is used to conduct a quantitative analysis of information in a financial statement. Ratios are calculated from current fiscal year numbers and are then compared with previous years and historic averages to determine the Postal Service's financial performance.

The ratios explain the Postal Service's financial health and provide valuable insight into its past performance. The financial data used in the ratio analysis is derived from accounting information not adjusted for inflation, changing demographics, industry dynamics, or government regulations. Financial analysis used in the private sector may not be directly relevant to government agencies because revenue streams, equity structures, and management incentives differ. It is also difficult to determine a single measurement that signifies financial health for a government agency. Financial performance, although not a primary indicator of success, influences the fulfillment of missions and objectives for government agencies with a service-related mission, such as the Postal Service.

Some of the ratios calculated by the Commission for FY 2015 show a slight improvement compared to the previous year with the majority deviating greatly from the average of the last 10 years. The Commission's *Financial Analysis* report calculates "liquidity-related ratios" as well as "key ratios" related to sustainability.

Liquidity-related ratios are one of the most widespread indicators of an agency's solvency. Calculated using the Postal Service's financial results for FY 2015, they show an improvement over the prior year with values close to the historic 10-year average. The following table details the three liquidity-related ratios:

Ratio Analysis of Postal Service Financial Statements

Ratios	9/30/2015 Value	9/30/2014 Value	Change	Description of ratio	Postal Service Historic 10 Year Average Value
Current ratio	0.16	0.15	0.02	This ratio is calculated by dividing current assets by current liabilities. It shows how much of an entity's short term assets are available to cover its short term debt obligations.	0.16
Quick ratio	0.16	0.14	0.02	This ratio is calculated by dividing liquid assets (cash, cash equivalents, short term investments, current receivables) by current liabilities. It shows how much of an entity's current assets which can be immediately converted to cash are available to cover its short term obligations.	0.15
Cash ratio	0.14	0.12	0.02	This ratio is calculated by dividing cash and cash related assets current liabilities. It shows how much of an entity's cash or cash related assets are available to cover its short term liabilities.	0.10

The improved liquidity-related ratios are largely a result of the increased cash on hand held by the Postal Service after exhausting its borrowing capacity. The Postal Service's working capital remains a negative value of $40.9 billion, deteriorating by $4.6 billion from the prior year. This means that the increase in current liabilities largely due to the missed retiree health benefit statutory prefunding payment of $5.7 billion significantly exceeded the growth in current assets, 87 percent of which is cash on hand.

The Commission's *Financial Analysis* report assesses three key ratios for Postal Service sustainability as detailed in the following table. Ratios for the current fiscal year as seen in the debt ratio and the current liability ratio have deteriorated compared to the prior year and the historic average for the past 10 years.

Ratio Analysis of Postal Service Financial Statements

Ratios	9/30/2015 Value	9/30/2014 Value	Change	Description of ratio	Postal Service Historic 10 Year Average Value
Debt ratio (debt to assets ratio)	3.10	2.97	0.12	This ratio is calculated by dividing total liabilities (*i.e.* long-term and short-term liabilities) by total assets. It shows how much the company relies on debt to finance assets.	1.78
Fixed assets to Net worth ratio	(0.31)	(0.36)	0.05	This ratio is calculated by dividing fixed assets by net worth. It shows how much of the entity's cash is frozen in the form of fixed assets, such as property, plant, and equipment.	0.58
Current liability ratio	0.66	0.62	0.03	This ratio is calculated by dividing current liabilities by total (*i.e.* current and noncurrent) liabilities. It shows the percentage of the entity's liabilities due within 1 year.	0.54

The accruing nonpayment into the statutory retiree health benefit fund has skewed the Postal Service's current liabilities in relation to its assets. To reduce its debt ratio to historic averages, the Postal Service would have to significantly increase its current cash position or investments in capital assets and reduce its obligations to the PSRHBF.

The Postal Service's fixed assets to net worth ratio shows an insignificant improvement reflecting the slight increase in capital spending and the comparative $447 million decrease in net loss over the prior year. However, the value still remains at negative 0.31, a result of recurring net losses accumulated over the last 9 years. A negative fixed assets to net worth ratio indicates the erosion through depreciation of the entity's long term tangible business assets, a critical investment for a viable entity.

The current liability ratio reflects the Postal Service's share of short term liabilities to total liabilities at 66 percent, an increase of 3 percent from the start of FY 2014. The accrual of the unpaid statutory PSRHBF prefunding payments is included in current obligations, accounting for the increase in current liabilities. An increasing current liability ratio indicates increasing obligations due to be paid within the current year. Understanding the Postal Service's liabilities is critical, especially as the cash flows generated from operations render the Postal Service unable to meet its current obligations.

Evaluating Financial Strength: Altman Z-Score

The Commission's *Financial Analysis* report also uses a financial analysis evaluating an agency's financial strength, defined as the Altman Z-Score, to calculate the possibility of bankruptcy. The users, stakeholders, and the business environment vary between the Federal Government and the private sector. Stakeholders of private sector entities use financial analysis to make investment and credit decisions, and success is often measured by the company's stock valuation. In contrast, Federal agencies are mission-oriented and measure success through the provision of service. Furthermore, unlike private sector firms, Federal agencies do not have direct shareholders whose income and wealth is affected by management decisions.

Financial analysis can be useful in both the Federal Government and the private sector. It can be used as a strategic management tool that provides the public with a concise and systematic way to organize the data in financial statements (e.g., balance sheets, income statements, and statements of cash flows) into meaningful information. The information derived from these indicators would provide the data needed to evaluate an agency's financial condition.

Financial viability is affected by a combination of environmental, economic, and organizational factors, including the decisions and actions of management and the governing board. For example, the decline in volume of First-Class Mail, which has a high-contribution margin (the decline being a negative environmental trend), can lead to the erosion of a healthy cost coverage base. However, Postal Service management's response to this decline and constraints on management flexibility also affect financial condition.

As detailed in the Commission's *Financial Analysis* report, the Commission calculated the Altman Z-Score to predict the probability of the Postal Service running out of cash to pay its creditors. Financial analysis evaluates the financial strength of an agency through the use of a variety of metrics. In conjunction with financial ratios, these metrics are used to gauge an entity's long-term viability. However, sometimes the agency's ratios reflect conflicting views. To help eliminate confusion, New York University Professor Edward Altman developed the Z-Score in 1968 as a tool to explicitly address the likelihood that a company could go bankrupt.

A quantitative model designed to predict the financial distress of a business, the Altman Z-Score uses a blend of the traditional financial ratios and a statistical method known as multiple discriminant analysis. The formula has achieved general acceptance by management accountants and auditors.

The Commission calculates the Altman Z-Score in its *Financial Analysis* report to predict the probability of bankruptcy of an entity with the attributes of the Postal Service. The Commission uses a factor model for a private non-manufacturer to evaluate the Postal Service's financial stability as follows:

Altman Z-Score = T1+T2+T3+T4 as denoted in the tables below.

The four performance ratios in the calculations are combined into a single score by weighting. The coefficients are estimated from a set of entities that have previously declared bankruptcy. A matched sample of entities is collected and matched by industry and estimated assets.

The Commission calculates that the Postal Service's Altman Z-Score was negative 6.1 on September 30, 2015. That means that there is a high probability that the Postal Service will go into financial distress. More commonly, a lower Altman Z-Score reflects higher odds of bankruptcy. This 2015 Altman Z-Score of negative 6.1 for the Postal Service is a setback from the FY 2014 score of negative 5.7 (and from the FY 2013 score of negative 5.5), and it is a significant deterioration from the positive score 10 years ago for FY 2005 of 0.3. Despite the results obtained, it should be mentioned that the Altman Z-Score as a predictor of the entity's bankruptcy probability is only relative, the structure of the Postal Service's ratios may be atypical, and interpreting the significance of the Z-Score would require deeper analysis by Postal Service management.

Altman Z-score, FY 2005

Ratio	Calculation	Ratio value on 9/30/2005	Weighting factor	Product (col. 3 * col. 4)
1	2	3	4	5
T1	Working Capital/Total Assets	(0.3)	1.2	(0.3)
T2	Retained Earnings/Total Assets	0.2	1.4	0.3
T3	Earnings/Total Assets	0.1	3.3	0.2
T4	Capital/Total Liabilities	0.3	0.6	0.2
	Altman Z-score			0.3

Altman Z-score, FY 2015

Ratio	Calculation	Ratio value on 9/30/2015	Weighting factor	Product (col. 3 * col. 4)
1	2	3	4	5
T1	Working Capital/Total Assets	(1.7)	1.2	(2.0)
T2	Retained Earnings/Total Assets	(2.1)	1.4	(2.9)
T3	Earnings/Total Assets	(0.2)	3.3	(0.7)
T4	Capital/Total Liabilities	(0.7)	0.6	(0.4)
	Altman Z-score			(6.1)

As the Commission concluded in its most recent *Financial Analysis* report, the deterioration in the Postal Service's viability relates to the erosion of retained earnings caused by consecutive net losses, the statutory obligation to prefund PSRHBF benefits, and decreasing Retained Earnings/Total Asset ratio. A comparatively lower Working Capital/Total Assets ratio results from the continued lag in replacement of its almost fully depreciated existing assets. The significant drop in these two measures causes the negative fluctuation to the Postal Service Altman Z-Score when comparing FY 2015 with FY 2005.

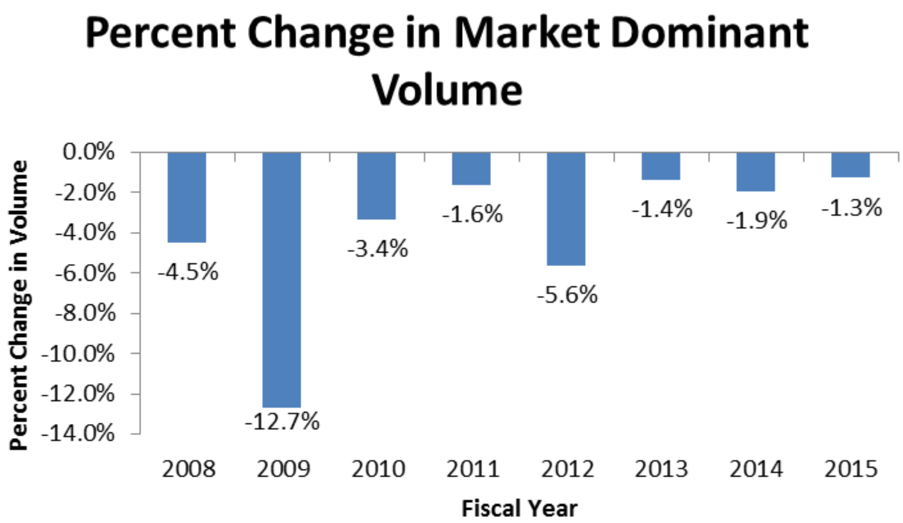
Total Mail Volume: Continuing Decline

Total mail volume in 2015 dropped to levels not seen in more than 27 years, and the Postal Service anticipates further reductions in total volumes for 2016. The decline in mail volume is the result of the economic recession that began in December 2007 along with the acceleration of a long-term trend of mail migrating to electronic media. According to the Postal Service, the volume lost to electronic alternatives is not expected to return because the movement constitutes a fundamental and permanent change in mail use by households and businesses.

Market Dominant Products: continuing decline, particularly in First-Class Mail

Total Market Dominant products volume declined by approximately 2 billion pieces, or 1.3 percent, in FY 2015. Over the last 8 years, Market Dominant products volume declined by approximately 60 billion pieces. Approximately 42 percent of the volume decline occurred in FY 2009 when Market Dominant volume declined 12.7 percent.

For specific products within the Market Dominant category, volume declines at different rates. In FY 2015, First-Class Mail volume declined by approximately 1.4 billion pieces, or 2.1 percent of total First-Class Mail, and Standard Mail volume declined by 284 million pieces, or 0.4 percent of total Standard Mail. These classes constitute the bulk of the volume of Market Dominant products overall. In FY 2015, First-Class Mail and Standard Mail accounted for 93 percent of the total mail volume. The decline in First-Class Mail is the most troubling as First-Class Mail contributes the most to the overhead costs of the Postal Service.



Competitive Products: continuing increases but lower margin

Volumes and revenues for Competitive products, which are mainly parcels, increased 16.3 percent and 8.9 percent, respectively, in FY 2015. While Competitive products volume and revenue has grown consistently in recent years, its volume only makes up 2.6 percent of the total mail volume of the Postal Service. In addition, the margin (i.e., the overall cost coverage) on Competitive products is lower than the margin for First-Class Mail. In other words, the Postal Service earns more money from First-Class Mail than it does from Standard Mail or Competitive Product parcels. Generally, it takes three pieces of Standard Mail to generate the equivalent profit as one First-Class Mail piece.

The continuous decline in First-Class Mail volume and revenue seriously jeopardizes the Postal Service's ability to cover its fixed overhead costs. As stated in the Postal Service's FY 2015 Form 10-K statement, "Although increased Shipping and Packages volume has offset some of these declines, [the Postal Service] must earn approximately $2.50 in Shipping and Package revenue to replace the contribution lost from each $1 of First-Class Mail revenue because the costs of transporting and delivering packages are significantly higher than letters. [The Postal Service's] challenge to contain costs is compounded by the continuing increase in the number of delivery points, which, when combined with the impact of the reduction in hard copy mail volume, has resulted in a drop in the average number of pieces delivered per delivery point per day from approximately 5.5 pieces in 2007 to 3.8 pieces in 2015, a reduction of approximately 31 percent."

Personnel Related Costs

In FY 2015, total personnel related expenses, including the payment to the PSRHBF and the non-cash adjustments to the workers' compensation, increased by $844 million or 1.5 percent from the prior year. The Postal Service continues to expense the amount payable to the PSRHBF, although it remains unable to make the actual payment into the fund. The last Postal Service payment to the PSRHBF occurred in 2010.

Beginning in 1989, the law requires the Postal Service to pay the government's share of the premium for its own annuitants, which, in FY 2015, amounted to $3.1 billion. In 2006, the Office of Personnel Management (OPM) estimated that the Postal Service needed to generate $75 billion to cover benefits for all its current and future retirees. The 2006 Postal Accountability and Enhancement Act (PAEA) established the PSRHBF to collect these payments from the Postal Service. Until 2006, the Postal Service had $0 (i.e., zero, nothing) set aside to pay for its future retiree health benefits.

In addition to the initial amount transferred from the Civil Service Retirement and Disability Fund of $17 billion into the PSRHBF upon enactment, the Postal Service paid $20.9 billion during the first 5 years after enactment of the 2006 law to meet this overly ambitious statutory requirement to prefund much of its future retiree health benefits. Presently, even though the Postal Service has not made any of the required prefunding payments in the past 5 years, there is $50.3 billion in the PSRHBF and a current unfunded amount of $54.8 billion (this is the portion that remains unpaid by the Postal Service).

Under current law, in addition to the Postal Service paying the normal cost amounts for retiree health benefits each year, the unfunded amount of $54.8 billion will be amortized over 40 years beginning in FY 2017. Also, in FY 2017, the PSRHBF starts paying the current year health benefits premiums.

From an operations standpoint, personnel costs increased by $1.5 billion in FY 2015 – a majority of which comprises compensation and retirement benefits. Compensation increased by $818 million while retirement benefits increased by $715 million. Compensation expenses grew over the previous year mainly due to the growth in Shipping and Package volumes, where, because of the size and shape of pieces, handling requires more workhours. An increase in wage rates also contributed to the growth in compensation expense, albeit to a lesser extent than the growth in workhours. As noted previously, retirement benefits expenses grew due to an OPM mandated increase in the agency annuity contribution rate for the FERS. Additionally, OPM notified the Postal Service that the FERS annuity account is underfunded by $3.6 billion as of the end of FY 2014. Under current law, the unfunded liability is to be amortized over 30 years, and this annual payment is estimated by OPM to be $241 million. The Postal Service has expensed this supplemental pension charge, but noted in its annual Form 10-K statement that it is reviewing OPM's underlying calculation regarding the unfunded pension estimate and has not yet paid this expense pending its review.

Summary: Significant Financial Obstacles for the Future

In summary, the Postal Service still faces significant financial obstacles for the future. Increases in revenues and subsequent higher liquidity are almost entirely due to the temporary Market Dominant product exigent surcharge. The additional revenue from Competitive products is not sufficient to offset the future revenue loss resulting from the termination of the exigent surcharge. The Postal Service collected all of the allowable additional revenue, $4.6 billion, from the temporary exigent surcharge. The surcharge was removed on April 10, 2016. In order to maintain the operating net income it is currently achieving, the Postal Service will have to make up the loss of that revenue, which is approximately $2.1 billion annually. With the growing liability of retiree health benefits, the inability to borrow for needed capital investments, and the continued loss of high margin First-Class Mail revenues, the important task of improving the financial condition of the Postal Service is daunting. As noted, its liabilities exceed its assets by $50.4 billion.

Universal Service Obligation (USO)

The cost of providing universal service in the U.S. is estimated by the Commission to be more than $4 billion annually. Title 39 U.S.C. § 3651(b)(1) requires the Commission to estimate in its *Annual Report to the President and Congress* the costs incurred by the Postal Service in providing three types of public services or activities: postal services to areas of the Nation the Postal Service would not otherwise serve; free or reduced rates for postal services as required by Title 39; and other public services or activities the Postal Service would not otherwise provide but for legal requirements. In the *Annual Report* issued in January 2016, the Commission estimated that the total of these three categories is $4.13 billion.

Aside from the financial pressure of generating sufficient funds to remain solvent, the Postal Service must also be concerned about how to fund this $4 billion in universal service obligations. This obligation is in addition to those monies required to keep the mail moving, undertake capital investments, and pay other multibillion dollar obligations such as retiree costs.

How does the United States define universal mail service? In 2008, the Commission, pursuant to law, determined that the USO has seven attributes: geography, range of products, access to facilities, delivery frequency, prices/affordability, quality of service, and users’ rights (or enforcement).

Other nations have imposed universal service requirements directly on their postal operator by statute, regulation, licensing, or contract. Countries like Australia, Canada, and Germany – just to name a few – have a detailed definition of universal postal service, with specific standards for delivery and retail access. Unlike other countries, the Commission concluded that the USO in the United States is largely undefined and instead is comprised of a broad set of policy statements with only a few legislative proscriptions. Aside from the annual appropriations mandate for the past 33 years to provide 6 days of delivery, Congress has rarely established rigid, numerical standards of minimally acceptable service for any of the attributes identified by the Commission. Rather, through its history, the Postal Service has been expected to use its flexibility to meet the needs and expectations of the Nation while balancing the delivery of service against budgetary constraints.

In the absence of a clear definition, particularly given the Postal Service's current financial challenges, each of us may have a differing view of what the Postal Service must provide in its services and operations to fulfill the USO, and since there is no specific agreed upon definition, all of our views will have different price tags. The Commission recommended in its 2008 report "that Congress consider and balance all the features of universal service as part of any review of changes necessary to preserve a financially viable Postal Service."

In 2007, the Federal Trade Commission (FTC) issued a report titled, *Accounting for Laws That Apply Differently to the United States Postal Service and Its Private Competitors, Federal Trade Commission, December 2007.* The report identified and quantified the economic burdens and advantages that exist by virtue of the Postal Service's status as a federal government entity and its postal and mailbox monopolies. The FTC determined, based on 2006 financial results, that the Postal Service's unique legal status ultimately put the Postal Service at an overall disadvantage in the Competitive product market. According to the FTC, the Postal Service's competitive products benefited from an implicit subsidy of between $39-$117 million per year associated with avoided Federal, state, and local legal requirements. However, the legal restraints imposed on it by Federal regulations cost the Postal Service an estimated

$330-$782 million a year in reduced efficiency in providing competitive products, according to the FTC.

Concluding Observations

Despite the bad financial news, there is good news, even if it is hard to see or seems overwhelmed by the financial position of the Postal Service. There is still strength in the system.

The Postal Service is the one government agency that touches every American on a daily basis; it is an organization that literally serves 155 million American households and businesses on a typical day. It facilitates trillions of dollars in commerce. According to the Envelope Manufacturing Association Foundation's Institute of Postal Studies, its 2015 Mailing Industry Job Study found that the Postal Service supports a $1.4 trillion mailing industry that employs 7.5 million people. The Postal Service is the key cog of a marketing and distribution system through which small and large businesses, nonprofit organizations, and consumers can transact business, advertise services, and distribute products. It is a significant driver of the Nation's economic engine and an essential piece of its infrastructure.

Throughout its 240-year history, the Postal Service has endured multiple economic recessions and a Great Depression. It has dealt with numerous disasters, which have interfered with mail delivery and strained the infrastructure. It has responded to these immense challenges by adapting, often despite predictions of failure or even its demise in the face of competition from new technologies.

With the inherent and underlying strength of the system, today's Postal Service can survive these challenges too. The fundamental problem as outlined in the Commission's testimony today is that the Postal Service cannot currently generate sufficient funds to cover its mandated expenses and also invest in critically deferred capital needs, such as new delivery vehicles and package sortation equipment. Despite the very serious and real financial problems, let's also keep in mind the good news – the strength in the system – and take some degree of hope knowing that this is the foundation that Congress and the Administration can build upon to find solutions. The strength in the system will be the engine that ensures the Postal Service will continue to meet its basic mission to "deliver."

Where Do We Go From Here?

The pressing question is "What needs to be done to improve the financial condition of the Postal Service?" The Commission has made recommendations on modifying the retiree health benefits funding and the computation of the liabilities for both retiree health benefits and pensions through separate studies on those topics and also in its first "*Section 701"* report issued in 2011. Section 701 of Title 39 mandates that the Commission, at least every 5 years, submit a report to the President and Congress evaluating the operation of the changes made by the PAEA and to make recommendations for any legislation or other measures necessary to improve the effectiveness and efficiency of our Nation's postal laws. Appendix A to this testimony is the Executive Summary from that 2011 report and outlines the Commission's previous recommendations on retiree health benefits funding as well as other concerns.

We are working on a new assessment to be issued later this year. On April 14, 2016, the Commission established a docket to receive public input and comment as the Commission prepares its second "*Section 701*" report. The requirements of section 701 allow the Commission significant discretion when providing recommendations to the President and Congress. The Commission is thus empowered to consider the PAEA amendment generally, as well as provide any appropriate recommendations related to the operations of the Nation's postal laws. However, to assist the public in focusing its comments and in furtherance of the Commission's mission of enhancing transparency and accountability of the Postal Service, the Commission identified several topics that were either highlighted in the 2011 Report and are not yet resolved, or other areas of interest. All interested parties must submit comments to the Commission under this docket no later than June 14, 2016.

The Committee's invitation letter also stated the Committee's interest in "the significance and potential implications of the Postal Regulatory Commission's December 2016 rate review." By law, after December 20, 2016, the Commission will review the price cap system for regulating Market Dominant products to determine if the system is achieving its statutory objectives and if it is not, to "make such modification or adopt such alternative system" to achieve the objectives. There are 9 objectives listed in the law that the modern rate regulation system must be designed to achieve, as well as 14 factors that the Commission must take into account. While each of the nine objectives must be applied in conjunction with the others, I would observe that relevant to the focus of today's hearing on Postal Service finances, objective number five is "[t]o assure adequate revenues, including retained earnings, to maintain financial stability."

In that regard, the PAEA requires that in its *Annual Report to the President and Congress*, the Commission must address “the extent to which regulations are achieving the objectives” for the setting of Market Dominant and Competitive product rates. In the *Annual Report* issued in January 2016, the Commission stated that in regard to the Market Dominant objectives, “[The law] establishes a tension between the restrictions of an inflation-based price cap on Market Dominant price increases and the objective that the Postal Service must be self-sufficient and maintain financial stability. Furthermore, though the PAEA provides incentives via the price cap to reduce costs and increase efficiency, it also imposes personnel-related expenses requiring the pre-funding of future healthcare costs for Postal Service retirees.”

While there are still more than 7 months until the Commission can legally commence its 10-year review, that does not mean we have not started seriously planning for it. The Commission has begun marshalling its limited resources to start identifying approaches to structure the review and schedule a process that allows full and open opportunities for those interested to participate. The Commission is sensitive to the high interest in the review and its potential outcomes. The Commission intends to inform the public about its plans for the 10-year review (including proposed schedules and opportunities for public comment) in advance of December 20, 2016, after which the review will, by law, begin.

There are no easy answers. But answer we must. I’ve outlined above some work that the Commission has completed and will be undertaking in this regard. The Commission stands ready to assist in your search for answers on behalf of our Nation’s postal system and the more than 320 million Americans who depend on it.

On behalf of all four Commissioners and the entire hard working agency staff, thank you for the opportunity to testify today. I am happy to answer any questions.

Appendix A: Excerpt from the Commission's 2011 "section 701" report (September 22, 2011)

CHAPTER I: EXECUTIVE SUMMARY

This marks the Postal Regulatory Commission's (Commission) first report under section 701 of the Postal Accountability and Enhancement Act (PAEA) of 2006. That section directs the Commission to submit a report to the President and Congress, at least every five years, regarding how well the PAEA is operating and to recommend measures to improve the effectiveness and efficiency of postal laws.

The Commission recognizes the difficult environment that the Postal Service faces in 2011 and how it is starkly different from the environment that existed in 2006. At the time of the passage of the PAEA, the Postal Service's volume was growing and it was earning revenues that exceeded costs. However, the postal sector and the financial condition of the Postal Service have dramatically changed since the passage of the PAEA.

This report does not propose sweeping structural changes to the Postal Service or its universal service obligation. Instead, in fulfillment of its responsibilities under PAEA section 701, the Commission makes recommendations for improvements to postal laws within the framework of the PAEA (701 Report). These recommendations will enhance the Postal Service's flexibility, and help it to meet the challenges of today's difficult financial environment.

The report focuses on three main areas that the Commission has been closely involved with in the implementation of the PAEA.

1) The report addresses the financial situation of the Postal Service with recommendations on retirement funding and discusses transparency issues with regard to Postal Service annual reporting, including Sarbanes-Oxley Act compliance.

2) The report discusses rate and service matters, including the price cap, market dominant classes of mail, nonpostal services, negotiated service agreements and special classifications, service performance measurement, and market tests.

3) The report addresses enhancements to improve the Commission's processes, including post office closing procedures and the advisory opinion process.

With respect to financial and transparency issues, the Commission makes the following key recommendation:

- The Commission recommends that Congress adjust the current Postal Service Retiree Health Benefit Fund (PSRHBF) payment schedule. To assist in determining how to make an appropriate adjustment, the Commission provides actuarially sound alternative payment options for Congress to consider in keeping with the spirit of the law while adjusting the scheduled annual prefunding payments in recognition of the current liquidity challenges facing the Postal Service. The Commission also recommends that Congress consider the PAEA section 802(c) report on the Postal Service's Civil Service Retirement System liability as a potential remedy for the PSRHBF issues.

With respect to rate and service matters, the Commission makes the following key recommendations:

- The Commission recommends that the PAEA be enhanced by explicitly allowing the Postal Service to add new market dominant classes of mail. This legislative enhancement will allow the Postal Service to adapt to the rapidly changing needs of mail users and the postal system.
- If Congress decides to allow the Postal Service to offer new nonpostal services, those services should have appropriate regulatory oversight and review. Proper regulatory review and oversight will ensure that the Postal Service offers profitable, new nonpostal services and does not disrupt the competitive marketplace.
- The Commission recommends that Congress consider amending the statute by raising the maximum revenue limitation on market tests of experimental products to encourage innovation on a larger scale.
- Congress should consider clarifying the law to ensure that consultations with the Commission are required for changes to service standards.
- While the Commission has not vetted this concept, Congress should consider providing an opportunity for the Postal Service to achieve increased pricing authority by increasing quality of service. This will provide the Postal Service with a financial incentive to improve service and increase revenues.

With respect to enhancements to improve the Commission's processes, the Commission makes the following key recommendations:

- The Commission recommends that Congress consider requiring the Postal Service to provide regular reports to the Commission on its retail network plans and activities. In recognition of the Postal Service's current plans to realign its retail network, regular reporting on the Postal Service's retail network's closure and consolidation efforts to Congress, the public, and the Commission will further the PAEA goals of transparency and accountability.

- The Commission recommends that the scope of appellate review from Postal Service determinations to close Postal Service operated retail facilities be clarified and adopt the plain meaning of post office to include all retail offices operated by the Postal Service.

- The Commission recommends that Congress consider adding statutory language that would allow the Postal Service to obtain expedited consideration for time sensitive requests for advisory opinions on proposals to change service on a nationwide or substantially nationwide basis. Additionally, Congress should consider adding language to 39 U.S.C. 3661 requiring the Postal Service to provide a written response to Commission advisory opinions and submit its response to Congress prior to implementing such changes in service.

Robert G. Taub
Acting Chairman
Postal Regulatory Commission

Robert G. Taub was designated Acting Chairman by President Barack Obama on December 4, 2014. He was sworn in as Commissioner in October 2011, following his nomination by President Obama and confirmation by the United States Senate. The Commission elected him Vice Chairman for calendar year 2013. Chairman Taub has 30 years of experience in public service. At the time of his appointment as Commissioner, Mr. Taub had been the Special Assistant to Secretary of the Army John M. McHugh since October 2009. In this role as an Army Department senior executive, he was one of the principal civilian advisors to Secretary McHugh, helping him oversee a workforce of more than 1.2 million people, and manage an annual budget over $200 billion. He was awarded the Army's Decoration for Distinguished Civilian Service.

Before his appointment to the Army, Mr. Taub served as Chief of Staff to U.S. Representative John M. McHugh for the preceding decade. As Chief of Staff, he oversaw the day-to-day operations of Representative McHugh's staff and offices in Washington, D.C. and Northern New York State. In a variety of leadership roles on the U.S. House Oversight & Government Reform Committee for 12 years, Mr. Taub also worked closely with Congressman McHugh on matters relating to the nation's postal and delivery sector. He crafted Representative McHugh's legislation for modernizing America's postal laws for the first time since 1970, culminating in passage of the Postal Accountability and Enhancement Act in 2006. Mr. Taub also helped Representative McHugh conduct hearings and investigations into postal operations that ultimately led to the enactment of a dozen other postal laws.

During his tenure in public office, Mr. Taub has addressed numerous national and regional conventions of postal employee organizations, mailing industry groups, and government and academic conferences both in the U.S. and abroad, on issues confronting the postal sector. The Inspector General of the U.S. Postal Service, postal employee unions, and mailing industry associations and nonprofits have all recognized Mr. Taub with several awards and honors.

Prior to his time with the House of Representatives, Mr. Taub worked for eight years at the U.S. Government Accountability Office (GAO), the investigative arm of Congress. As a senior policy analyst, Mr. Taub planned and directed evaluations for the Congress on environmental, banking, energy, and defense issues. Previous to his position with the GAO, Mr. Taub worked as a staff member for three different Members of Congress, a Member of the British Parliament, and state and county officials in upstate New York.

A native of Gloversville, New York, Mr. Taub earned an M.A. in Political Science, with a concentration in American politics, and a B.S. in Political Science with Honors, both from American University in Washington, D.C. He is a Fellow of the National Academy of Public Administration.