**Testimony of**

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**Postal Regulatory Commission**

**Before the**

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## Introduction

Chairman Cummings, Ranking Member Jordan, and members of the Committee on Oversight and Reform, good morning. My name is Margaret Cigno. I am the Director of the Office of Accountability and Compliance at the Postal Regulatory Commission (Commission). I am pleased to testify before you today.

## Background

The Commission is an independent Federal agency that provides transparency and accountability of the U.S. Postal Service's operations and finances. It is composed of five Commissioners, each appointed by the President and confirmed by the Senate. The 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.

The Commission carries out this work with a very small budget and staff. Its current year appropriation is $15.2 million to regulate the $71 billion Postal Service. Commission funding comes entirely from the off-budget, permanently appropriated, Postal Service Fund, which is wholly comprised of ratepayer--not taxpayer--funds.

## Commission Budget Process

For 38 years since its creation in 1970, the Commission requested and received its funding directly from the Postal Service out of the Postal Service Fund. Funding requests were deemed approved by the Postal Service's President-appointed-Senate-confirmed Governors unless adjusted by their unanimous written decision.

Passage of the Postal Accountability and Enhancement Act (PAEA) transferred the Commission into the annual appropriations process. Congressional intent was to ensure the financial independence of the newly modified agency from the Postal Service. Despite now being part of the appropriations process, the Commission's budget continues to come solely from the off-budget Postal Service Fund.

While the idea of transferring the Commission into the appropriations process was reasonable in theory, the recent government shutdowns in 2013 and 2019 have shuttered the Commission while the Postal Service remained open. This is a serious problem, with a direct impact on sorely needed Postal Service revenues as well as for the Commission's critical postal oversight on behalf of the American public. In testimony last month before the Senate, Commission Chairman Robert Taub asked that Congress consider reverting the Commission's budget process to the 1970 language. Given that both previous legislation of this Committee and last year's report by the President's Task Force on the Postal System recommend an enhanced regulator, I wanted to take the opportunity to highlight the Commission's funding dilemma.

**Commission Focus on Postal Service Financing**

The U.S. Postal Service is a $71 billion operation with over 600,000 employees. The Postal Service receives no tax dollars for operating expenses but rather relies on the sale of postage, products, and services to fund its operations.

Commission rules require the Postal Service to file several financial reports with the Commission on a monthly, quarterly, and annual basis. The Commission staff then analyzes these reports. Prior to Fiscal Year (FY) 2013, the Commission's *Annual*

*Compliance Determination* (ACD) included a chapter on financial information. Starting in FY 2014, the Commission developed a separate *Financial Analysis* to provide greater clarity, transparency, and accountability of the Postal Service's financial data and trends.

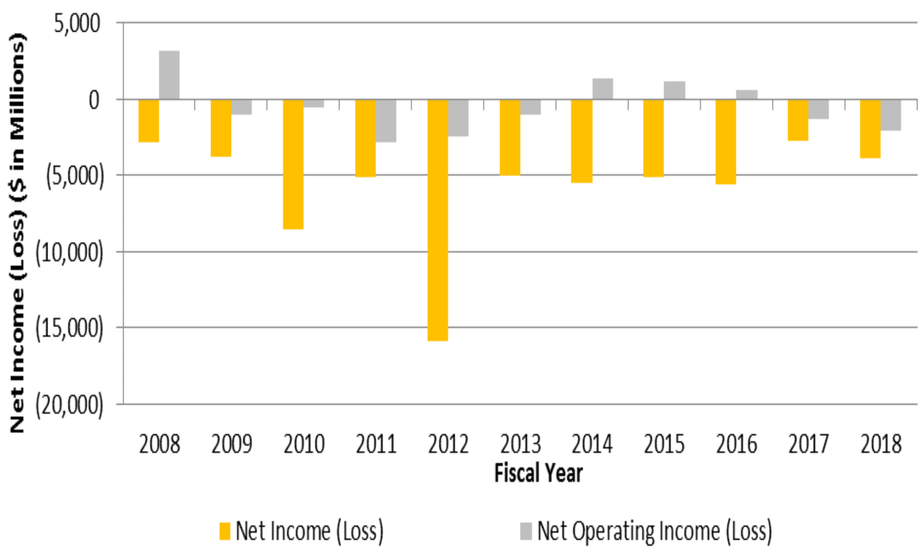
This financial analysis not only reviews the overall financial position of the Postal Service, but also analyzes volumes, revenues, and costs of both Market Dominant and Competitive products. The report includes a chapter that analyzes the Postal Service's financial status in terms of profitability, solvency, activity, and financial stability using accounting ratios. The FY 2018 report was issued on April 19 and a copy is included with this testimony. I would like to highlight some of the Commission's conclusions from this year's *Financial Analysis* report.

**<u>Overview of Postal Service Finances</u>**

In FY 2018, the Postal Service recorded a net loss of $3.9 billion. This was the eleventh consecutive net loss posted since FY 2007 and has increased the cumulative net deficit to $62.6 billion. As part of a detailed financial analysis of the Postal Service's Income Statements, the Commission also analyzes the net loss from operations. Net loss from operations excludes from expenses the payments for unfunded retirement health benefits (RHB), the supplemental contribution to the Civil Service Retirement System (CSRS) annuity, the supplemental contribution to the Federal Employees Retirement System (FERS) annuity, and the non-cash adjustments to the workers' compensation liability. In FY 2018, the Postal Service recorded a net loss from operations of $2.1 billion. The net loss from operations is largely due to declining Market

Dominant volume and higher operating expenses. The net operating loss is nearly $748 million more than the FY 2017 operating loss. Figure 1 shows the net income (loss) and net operating income (loss) for the last 10 years.

**Figure 1: Postal Service Income (Loss), FY 2008 – FY 2018**

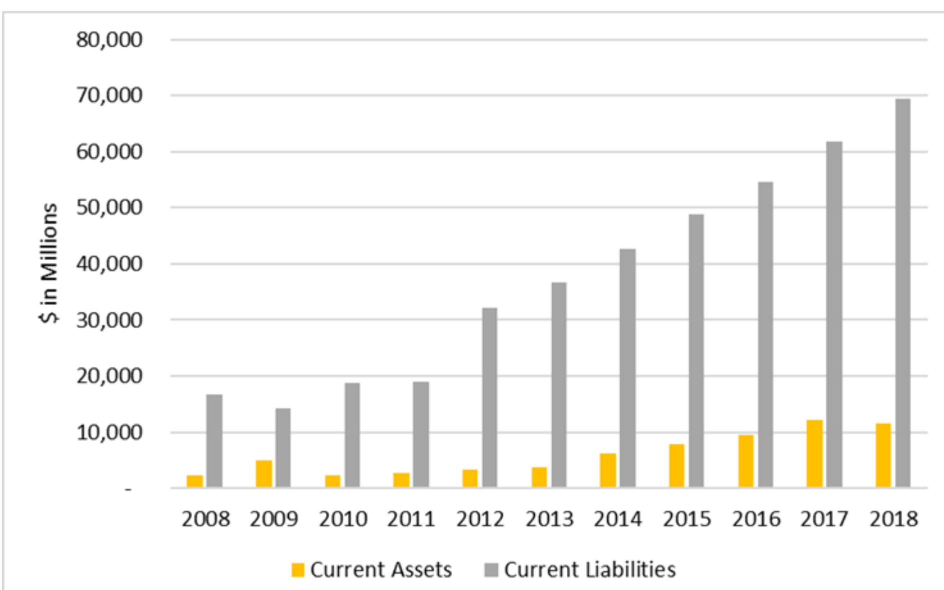



These continuing losses have negatively affected the financial position of the Postal Service, creating a substantial gap between the Postal Service's assets and liabilities. During FY 2018, total assets decreased by $0.7 billion while total liabilities increased by $3.2 billion. At the end of FY 2018, the Postal Service recorded total assets of $26.7 billion and total liabilities of $89.3 billion.

Total assets and liabilities are comprised of current and noncurrent portions. Current assets are the sum of cash and cash equivalents, receivables, and supplies and prepayments, which can be easily converted to cash for financing operations. Non-current assets are mainly buildings and equipment and are more difficult to convert to cash in the short term. Current liabilities are obligations that will come due within one year while noncurrent liabilities are long-term financial obligations. Current liabilities consist largely of missed payments for statutorily required prefunding of the RHBF and amortization of unfunded RHB obligations, defaulted payments for amortization of unfunded CSRS and FERS obligations and short-term borrowing. In FY 2018, the Postal Service continued to accrue unpaid RHB expenses. At the end of FY 2018, the unpaid amount, which includes accruals for FY 2012 through FY 2018, amortization payments on the unfunded obligations, and normal costs, totaled $42.6 billion.

In FY 2018, the Postal Service had current assets of $11.6 billion and current liabilities of $69.5 billion. If current assets are insufficient to meet its short-term liabilities, the Postal Service could have problems paying its creditors in the short term. As seen in Figure 2, the gap between current assets and current liabilities has increased substantially since FY 2008.

**Figure 2: Current Assets and Liabilities FY 2008 – 2018**



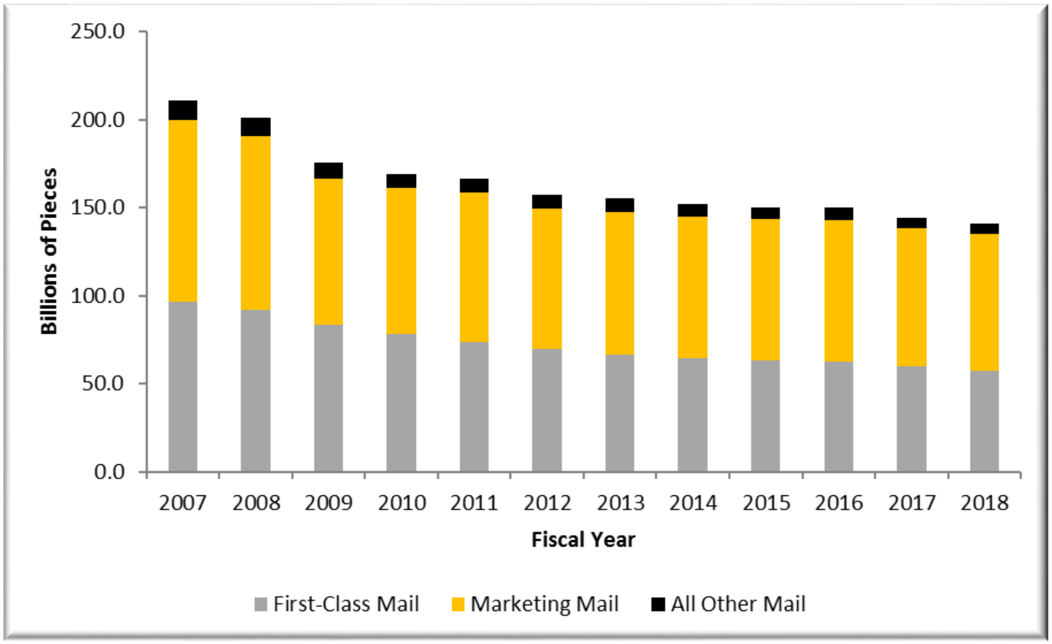
At the end of FY 2018, the Postal Service's cash and cash equivalents total was $10 billion. For the first time since FY 2012, the Postal Service has available borrowing authority ($1.8 billion), resulting from fourth quarter payments to the Federal Financing Bank that reduced its debt below the debt ceiling of $15 billion. Although cash declined during FY 2018, the Postal Service's liquidity position is at the highest level since FY 2007. However, the significant balance sheet liabilities and off-balance sheet unfunded liabilities for pension and annuitant health benefits threaten the improvements in liquidity.

## Mail Volume and Revenue

Total mail volume in FY 2018 continued to decline, falling 2.1 percent from FY 2017 levels, and the Postal Service anticipates further reductions in total volumes for FY 2019. The continued decline in mail volume is the result of many factors including 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 volume declined by 3.7 billion pieces, or 2.5 percent in FY 2018. Over the last 12 years, Market Dominant products volume has declined by approximately 70 billion pieces. First-Class Mail and USPS Marketing Mail accounted for 95.8 percent of total Market Dominant volume in FY 2018. First-Class Mail volume has declined by 39 billion pieces since FY 2007, representing a 39 percent loss in volume. USPS Marketing Mail volume has also declined considerably, by 26 billion pieces since FY 2007. Figure 3 illustrates these declines.

**Figure 3: Market Dominant Products Volume, FY 2007 – FY 2018**




While volumes for Competitive products, which are mainly parcels, continued to grow in FY 2018, the rate of increase was lower than in recent years. Competitive volume increased approximately 11 percent in FY 2018 compared to 13.4 percent in FY 2017, 13.6 percent in FY 2016, and 14.8 percent in FY 2015. The product with the largest increase in volume was First-Class Package Service, which increased 32.8 percent, in part due to the transfer of single-piece retail parcels from the Market Dominant product list to a new “Retail” rate category within the First-Class Package Service product. Priority Mail and ground parcels volume increased more modestly in FY 2018, 5.0 percent and 7.5 percent, respectively.

Total Competitive product revenue increased 11.5 percent, or $2.4 billion, in FY 2018. Revenue for every domestic Competitive product except Priority Mail Express increased, mirroring increases in volume. On a unit basis, average revenue increased by approximately 4 percent for all domestic Competitive products.

While Competitive products volume and revenue has grown consistently in recent years, its volume only makes up 3.9 percent of the total mail volume of the Postal Service. Competitive products account for 35.2 percent of total attributable costs and 28.5 percent of total contribution to institutional costs.

## Expenses

Total expenses increased in FY 2018 by $2.2 billion or 3.1 percent from the prior year. The Postal Service continues to expense the amount payable to the RHBF, although it remains unable to make the actual payment into the fund. It has not made a payment to the RHBF since 2010. In addition, beginning in FY 2017, the Postal Service was supposed to begin paying the amortization of the unfunded retirement benefits for FERS and CSRS. In FY 2018, the Postal Service incurred a FERS unfunded liability amortization expense of $1 billion and a CSRS unfunded liability expense of $1.4 billion, which it did not pay. Table 1 shows the unpaid retirement expenses for the past two years.

**Table 1: Postal Service Unpaid Retirement Expenses, FY 2018 and FY 2017**

| | FY 2018 | FY 2017 | $ Variance |
|---|---|---|---|
| Annual Amortization of CSRS Unfunded Liability | $1,440 | $1,741 | $(301) |
| Annual Amortization of FERS Unfunded Liability | 958 | 917 | 41 |
| Amortization of RHBF Unfunded Liability | 815 | 955 | (140) |
| Normal Costs of Retiree Health Benefits | 3,666 | 3,305 | 361 |
| **Total Retirement Expense** | **$6,879** | **$6,918** | **$(39)** |

Decrease in expenses is denoted by ().
Numbers may not add across due to rounding.
Source: Postal Service FY 2018 Form 10-K at 20.

## Cost Structure

The Commission is required by 39 U.S.C. § 3622(c)(2) and § 3631(b) to define attributable cost as the "direct and indirect postal costs attributable … through reliably identified causal relationships." In Order No. 3506, the Commission revised the methodology for determining attributable cost to include inframarginal costs developed as part of the estimation of incremental costs. Previously, attributable cost only included the sum of volume-variable costs, which in the aggregate, increase as volume increases and decrease as volume decreases, and product-specific fixed costs, which are costs caused by a specific product or class but do not vary with volume. Under the revised methodology, attributable costs are equal to incremental costs, which reflect the total marginal costs of the volume in a class or product. Attributable cost is distributed to products using distribution keys that reflect the underlying cost drivers.

Institutional cost cannot be attributed to a specific product or service and is equal to total cost minus total attributable cost. While sometimes referred to as "fixed cost," it is more accurately characterized as "common cost" because it includes costs that are variable but not causally related to an individual product or class. Institutional cost includes costs for carrier network travel time, amortization of unfunded retiree related liabilities apportioned to prior years, and various administrative costs.

The institutional cost share is the ratio of total institutional cost to total costs. Holding all else equal, a higher mail volume results in a lower institutional cost share and a lower mail volume results in a higher institutional cost share. Changes in operational factors such as volume mix, as well as non-volume operational factors such as changes in the number of delivery points, also affect institutional costs. Annual changes in institutional cost are primarily driven by accruals for retirement-related expenses, workers' compensation, and delivery network costs. Therefore, institutional cost will increase or decrease depending on changes to retirement obligations, interest rate fluctuations that impact the workers compensation liability, and increases in delivery points or changes due to restructuring routes. Table 2 shows the causes of the changes in institutional cost each year since FY 2010. The largest drivers of the year-to-year changes have been workers' compensation and annuitant health benefits, and amortization on unfunded retirement funds rather than changes in operational costs.

**Table 2: Main Sources of Change in Institutional Cost, FY 2010 – FY 2018**

| | FY 2018 ($ 000) | FY 2017 ($ 000) | FY 2016 ($ 000) | FY 2015 ($ 000) | FY 2014 ($ 000) | FY 2013 ($ 000) | FY 2012 ($ 000) | FY 2011 ($ 000) | FY 2010 ($ 000) |
|---|---|---|---|---|---|---|---|---|---|
| Workers' Compensation | 1,001,539 | (3,419,553) | 965,985 | (654,814) | 1,290,341 | (2,600,835) | (99,435) | (48,990) | 1,189,647 |
| Annuitant Health Benefits | 13,942 | (4,913,951) | 388,908 | 27,737 | 332,737 | (5,124,055) | 11,471,877 | (5,109,985) | 4,460,307 |
| CSRS Supplemental Liability | (269,554) | 1,549,748 | - | - | - | - | - | - | - |
| City and Rural Carriers | 366,526 | 476,736 | 412,202 | 480,678 | (109,145) | 29,037 | 270,852 | 240,636 | 103,512 |
| FERS Supplemental Liability | 41,629 | 668,715 | 149,024 | 102,998 | 2,664 | 407 | 309 | (276) | 563 |
| Transportation | 98,572 | 579,903 | 103,181 | (31,117) | (23,560) | 15,148 | 21,239 | 46,419 | 7,033 |
| Supplies and Services | 3,306 | 73,733 | 116,728 | 19,641 | 43,336 | 113,029 | (56,587) | 114,221 | (100,798) |
| Clerks and Mailhandlers | 47,675 | 40,987 | 116,610 | 243,895 | 69,139 | 39,877 | (34,660) | (110,561) | (206,751) |
| Other | (441,994) | (7,065) | 424,112 | (442,208) | (546,099) | 84,464 | (515,960) | 458,194 | (197,967) |
| **Total Cchange** | **861,641** | **(4,950,746)** | **2,676,750** | **(253,189)** | **1,059,414** | **(7,442,928)** | **11,057,636** | **(4,410,343)** | **5,255,547** |

Source: The Postal Regulatory Commission derived from Postal Service Cost Segment and Component Reports, FY 2010 to FY 2018.

**Commission's Reviews**

Every 5 years the Commission is required to issue a report on the Commission's assessment of how well the PAEA is operating and to recommend legislation or other measures necessary to improve the effectiveness and efficiency of our Nation's postal laws. The Commission's 2016 report emphasized the changes in circumstances faced by the Postal Service since the PAEA's enactment in 2006. At the time of enactment volume was growing and the Postal Service was earning net income. That is no longer the case. In its 2016 report, the Commission found that the most important legislative recommendations it could make related directly to improving the financial condition of the Postal Service.

In 2017, the Commission issued its findings related to the system for regulating rates and classes first established in 2006 by the PAEA. In accordance with the statutory mandate set forth in 39 U.S.C. § 3622(d)(3), the Commission was required to review the past 10 years of the existing market dominant rate and classification system to determine if the system has achieved the objectives of 39 U.S.C. § 3622(b), taking into account the factors enumerated in 39 U.S.C. § 3622(c). In its review the Commission organized its ultimate findings around three topical areas which encapsulate the nine objectives: (1) the structure of the ratemaking system; (2) the financial health of the Postal Service; and (3) service. After extensive review, the Commission concluded that while the system achieved some of the goals of these areas, the overall system has <u>not</u> achieved the objectives taking into account the factors of the PAEA.

Of relevance to this testimony, with respect to finances, the Commission found that the system has not maintained the financial health of the Postal Service as intended by the PAEA. While the Postal Service has generally achieved short-term financial stability, both medium-term and long-term financial stability measures have not been achieved. For the medium-term measure, the total revenue was not sufficient to cover total costs. For the long-term measure, the Postal Service has not been able to generate retained earnings during the PAEA era. In its review of the financial health of the Postal Service, the Commission also found that while some cost reductions and efficiency gains occurred during the PAEA era, the incentives were not maximized in a way that allowed the Postal Service to achieve financial stability. Although the system contained a mechanism to appropriately allocate institutional costs and was able to enhance mail security and deter terrorism, there was not an adequate mechanism to maintain reasonable rates during the PAEA era because certain products and classes failed to cover their attributable costs, further threatening the financial health of the Postal Service.

The Commission's analysis of the PAEA era system led it to conclude that while some aspects of the system of regulating rates and classes for Market Dominant products have worked as planned, overall, the system has not achieved the objectives of the PAEA. As a result, the Commission concurrently issued a Notice of Proposed Rulemaking (NOPR) to address the shortcomings identified by the Commission in its review. The Commission is currently considering rules to modify existing regulations or adopt an alternative system that the Commission believes will achieve the objectives of

3622. The Commission is considering the comments received in response to its NOPR and expects to respond soon.

**Summary: Significant Financial Obstacles for the Future**

In summary, the Postal Service still faces significant financial obstacles for the future. Continued losses, including two consecutive years of growing operating losses, have put the Postal Service in a perilous financial position. With the growing liability of retiree health benefits, the inability to sufficiently fund needed capital investments, and the continued loss of high margin First-Class revenues, the important task of improving the financial condition of the Postal Service is daunting.

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.

Thank you for the opportunity to testify today. I am happy to answer any questions.