

**STATEMENT OF  
POSTMASTER GENERAL/CEO  
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BEFORE THE  
SUBCOMMITTEE ON FEDERAL WORKFORCE, POSTAL SERVICE,  
AND THE DISTRICT OF COLUMBIA  
OF THE  
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM  
UNITED STATES HOUSE OF REPRESENTATIVES  
WASHINGTON, DC**

**FEBRUARY 28, 2008**

Good afternoon, Chairman Davis, Congressman Marchant, and members of the Subcommittee. I am pleased to have the opportunity to report to you today on the status of the United States Postal Service as we work with our employees, with our customers, and with other agencies of the federal government to implement the provisions of the Postal Act of 2006.

In testimony before this Subcommittee last year, I discussed the fundamental changes the new law brings to the operation of the Postal Service. These fall into three primary areas: the division of our business into market-dominant and competitive products; new, flexible, and different pricing systems for each of these product groups; and the replacement of a break-even financial requirement with one that permits retained earnings or, simply put, profit.

I believed then, as I believe now, that the new law offers the Postal Service tremendous opportunities. I believe that these opportunities can and will benefit every user of the mail, from the consumer to the small business to each and every part of the world's most advanced and innovative mailing industry – the organizations that rely on the mail as a welcome, efficient, and cost-effective method to connect with their business partners and customers.

Their success is an engine that creates employment, produces and invests revenue, funds the operation of government at every level, and supports local, regional, and national economies – both directly and through closely linked supply chains.

With a network that is – and must remain – capable of reaching 148 million delivery addresses every day – a delivery base that expands by some two million each year – America's postal system is extremely sensitive to fluctuations in the economy, both as they affect us and as they affect mail users.

We are now almost halfway through our first full fiscal year of operation under the new law. In addition to the \$5 billion net loss we incurred last year as a result of the transition to the pre-funding of our retiree health benefits obligation, we are facing a potential net loss of over \$1 billion this fiscal year. Later in my testimony, I will discuss how we are addressing this challenge.

It is reasonable to ask “how did we get here?” Just one year ago, the Postal Service was developing plans that would build on our successes and take advantage of the new approaches defined by the new law. We had just completed a year marked by record mail volume – more than 213 billion pieces, reflecting the robust condition of the economy. Service was strong. We were preparing to adjust our prices in May to offset a sharp surge in energy and other costs, and to provide incentives for mailers to shift volume to shapes and sizes that our system can process more efficiently. As it had since the Postal Service supplanted the heavily-subsidized Post Office Department in 1971, the average price of a stamp would continue to track inflation.

While a price change often results in short-term mail volume declines, volume returns to – and generally surpasses – previous levels relatively quickly. This was not the case as we ended fiscal year 2007 and moved into fiscal year 2008.

As the pace of economic growth began to slow down late in 2007, mailers compensated by adopting these incentives quicker than our plans had anticipated, negatively affecting our revenue projections.

In some ways, the current weak economy has disproportionately affected Postal Service revenue. The financial, credit, and housing sectors are among the key drivers of our business. With recessionary trends in these normally strong sectors, mail volume and revenue began a strong and steady decline. As we approach the mid-point of our fiscal year, we see deterioration continuing, with no signs of improvement.

Tighter credit means less credit prospecting, with offers of credit far more limited than previously. Consumer confidence is down. The recent holiday season registered the weakest retail sales since 2002. And with reduced consumer spending, there is less demand for shipping.

The problems in the mortgage and housing markets have resulted in a slowdown of new construction and a surplus of unsold new homes. With fewer new households, there is less growth opportunity for catalogs, magazines, and other mail.

Since the widespread adoption of the Internet and other electronic communications, their functionality has moved from informational to transactional. This has resulted in a steady erosion of First-Class mail, historically our most profitable product. As the current economic conditions place added pressure on profit margins, we are seeing a growing number of businesses offer incentives and add new charges to increase the rate of conversion to electronic bill presentment and payment.

This has driven a shift in mail usage. Today, Standard Mail – largely catalogs, advertisements, and offers – has supplanted First-Class Mail as our largest product. This has made us far more sensitive to downturns in the economic cycle, as advertising spending is extremely vulnerable to periods of retrenchment. And, while advertising alternatives may not offer mail's advantages, particularly in terms of targeting, personalization, or effectiveness, there are signs that advertisers and marketers are shifting a portion of their spending to lower-cost electronic media.

During previous slumps, we could expect advertisers to return to the mail as the economy improved. However, because electronic channels were not available in the past, we expect that some mailers will shift a portion of their spending permanently to these lower-cost media, contributing to the ongoing structural change in mail usage.

We are also facing “Do Not Mail” legislative initiatives in some 15 States. These not only threaten the viability of the mail in and among the affected states; they also undermine our ability to support a national network, one capable of serving every resident of every state, territory, and possession – affordably, effectively, and efficiently. We believe the success of these initiatives will also come at the expense of jobs, the viability of local businesses, and the reduction in municipal, county, and state revenue. We cannot afford these results during the best of times; they are unthinkable when the economy is faltering.

These conditions have had a material and negative effect on our bottom line. Our first quarter, which coincides with the historically busy holiday mailing season, did not record any volume growth. In fact, it was the first time that holiday mail volume was less than that of the previous year.

Overall, mail volume declined by 3 percent, with virtually every product category down. As a result, our revenue was \$523 million below plan. Net income fell short of our expectations by \$183 million.

First-Class Mail, our largest revenue producer, fell by almost 1 billion pieces, some 4 percent below the same period last year. Standard Mail, which eclipsed First-Class Mail as our largest volume product in 2005, declined by almost 750 million pieces, 2.6 percent less than the first quarter of 2007. There are no current signs of improvement for quarter 2.

Ultimately, less mail volume results in less revenue to support infrastructure. That means higher costs per piece of mail handled. Our fixed delivery costs are the same for bringing one piece of mail to your door as they are for twenty. As the only delivery service provider with a universal service obligation, we cannot offset costs by offsetting service levels.

Our mission is to provide uniform service at a uniform price to everyone, everywhere, every day. This mission does not change, whether the economy is growing or declining. And, because Postal Service operations are not dependent on tax dollars – they are funded by the sale of our products and services – we must carefully manage costs and pursue profitable growth opportunities to maintain the reach and effectiveness of the nation's postal system. Cost cutting alone will not help us achieve prosperity. Rather, it risks undermining service levels. This, in turn, would diminish confidence in our brand, not only limiting growth opportunities but driving customers to other channels and competitors.

As we faced the fiscal realities of an extremely difficult first quarter, we could not lose sight of these issues. I am pleased to say that the men and women of the Postal Service were up to the challenge. For more than 230 years – during good times and bad – they have demonstrated their grit, professionalism, and commitment to service. The last several months have been no exception.

With less mail coming in, they realigned resources, quickly bringing down spending. They adjusted transportation to match volume. They reduced expenditures for supplies, services, and other non-personnel expenses. They used less overtime and increased the use of seasonal employees, consistent with the provisions of our labor agreements. While they did bring spending considerably below plan, even these reductions could not close the huge revenue gap created by the sudden, steep, and ongoing decline in mail volume.

Those important operational decisions, made in the field and at national headquarters, went beyond the simple exigencies of quarterly financial results. They were also focused on longer term needs. Our people understood that our financial challenges existed separate and apart from customer expectations. If we were not meeting or exceeding those expectations, we risked having customers take their business elsewhere. Only by protecting service – even as we cut costs – could we create an environment that will support growth when the economy begins to recover.

The good news is that we not only met customer expectations, but from a service perspective, we had the strongest first quarter in our history. This is traditionally our most difficult quarter, coinciding with the onset of severe winter weather and the pressures of the holiday mailing season. Independently measured on-time delivery of single-piece First-Class Mail committed for next-day delivery reached 96 percent, two-day mail rose to a record 93 percent, and three-day mail held at a first-quarter high of 88 percent. Two of our 80 field districts achieved an overnight on-time rate of 98 percent; another five scored a 97 percent.

We saw similar progress with remittance mail – largely payments to banks and credit card companies. Bill payments are so time-sensitive that mailers measure our performance in hours, not days. The latest report from Phoenix-Hecht – prepared by the industry for the industry – shows that we reduced two hours from our payment processing and delivery time since the last report, just six months ago. With an economy defined in part by credit problems, delivery speed means more than ever for these customers. Every extra hour they have access to their payments makes a difference to them.

It makes a difference to us, as well. Our speed in delivering these payments, combined with the extraordinary levels of trust Americans have in the mail, can keep us competitive in this market.

In 2007, for the third time in a row, the respected Ponemon Institute has rated the Postal Service as the most trusted government agency and one of the ten most-trusted organizations in the nation – public or private.

This is an extremely important differentiator as consumer concerns about identity theft continue to grow. Amid these concerns, new data collected by the Federal Trade Commission confirm that although there are many sources of identity theft, the mail is, by far, one of the least significant. Only two percent of those surveyed identify the mail as a source of this crime. This reflects the vigilance and effectiveness of the Postal Inspection Service in bringing perpetrators to justice, in serving as a deterrent through their effective investigations, and in participating in education and awareness programs that help consumers protect themselves.

It should come as no surprise that customer satisfaction with the mail remains extremely high – among the highest of many consumer products and services. Ninety-two percent of residential customers rate their experience with the Postal Service as excellent, very good, or good.

These results, also independently measured, were echoed in a recent Roper Poll showing that the American people view their Postal Service more favorably than any other federal agency rated – with almost half reporting that they view us “very favorably”. We have held this top position for ten years.

As we reach out to serve the world’s markets, we are pleased that by the end of fiscal year 2007, each of our five International Service Centers – in Chicago, New York, San Francisco, Los Angeles, and Miami – received the Certificate of Excellence awarded by the International Post Corporation. These facilities serve as our primary hubs for international mail. The certification is the result of a rigorous, 140-step evaluation process to identify facilities that have achieved the highest standard of mail processing efficiency. The United States Postal Service was the first to be recognized with certification for each of its international facilities.

Not only did our employees deliver the best service ever during 2007, they also made it our safest year, with continuing declines in industrial and motor vehicle accidents. We have developed effective partnerships and agreements with our four major unions and with the Occupational Safety and Health Administration, and they are improving workplace safety. The direct beneficiaries are our employees and their families.

The Postal Service also offers access no other business can match. With 37,000 postal facilities, our retail network is the largest in the nation. More than 45,000 retail partners make postage stamps as convenient as a trip to the supermarket, drug, greeting card, or convenience store. Each of our 77,000 rural delivery routes serves as a Post Office on wheels. Our carriers will pick up packages and mail at your home, your business, and at more than 300,000 blue collection boxes. And just about everything you can do at the Post Office, you can do online, at our website, [usps.com](http://usps.com) – it’s the Post Office that never closes.

While our brand is sound and our business, in many ways, is well-positioned to rebound with the economy, even the experts are unsure about the duration or ultimate extent of the current downturn. We are encouraged by the actions of Congress, the White House, and the Federal Reserve in working to strengthen the economy. We believe that a successful stimulus package can create the necessary conditions that will stabilize and contribute to reversing current mail-volume trends.

However, we cannot simply wait for a recovery. We must act now to pursue the strategies that will help us close this year's budget gap. We cannot afford – literally or figuratively – to begin the first year under a price cap system more than \$1 billion in the red. We would never be able to dig out of that hole. To avoid this, we are following a two-part strategy: prudent cost management and focused revenue growth.

We have closely reviewed all of our costs and the immediate opportunities for efficiency improvements – at every level of the organization and in operational and administrative functions. We have identified savings of an additional \$1 billion dollars over the \$1 billion already built into our budget. Our leadership has made a commitment to achieve every penny of the savings identified in their areas. We will meet this goal. And we are clear in our resolve that it will not come at the expense of service.

Just as importantly, the active pursuit of growth must be – and has become – an integral element of our business. We are long past the time when we could expect steady, year-after-year mail volume growth to produce the revenue necessary to pay for a continually expanding network – one that links every family and business in the nation with every other.

The market in which we operate continues to grow more competitive. This means that the Postal Service must become more flexible if it is to remain competitive and successfully meet its obligations to the nation. The Postal Act of 2006 provides us with new tools that are intended to help us do this. This includes new approaches to pricing, intended to foster revenue growth.

Throughout the entire Postal Service, employees recognize that the new law has fundamentally changed the way we do business. They know that revenue growth and profit are necessary to a secure future. They understand that their success is dependent on the organization's success. They realize that operational excellence and customer focus go hand in hand. It cannot be one or the other. It must be both.

Our first full year of operation under the provisions of the new law is also the first year of new, multi-year, collective-bargaining agreements with each of our four major unions. This is the first time in a generation that the new agreements have become effective at virtually the same time. This puts all of us on the same starting line, at the same time, prepared to face a challenging new world together.

I appreciate the recent dialogue I have had with union leadership about opportunities for growth and ideas on employee efforts to fully educate our customers on our services. I also have shared with our unions the concepts behind our pricing strategies and sought their input, which has been helpful and valued. Despite this, there are issues such as contracting where differences remain. We are engaged in a constructive dialogue to discuss with the unions possible options regarding delivery services and the processing network.

I am, however, encouraged that the unions and management are in agreement on some of the key issues that are facing us. There is unanimity on the need for growth. There is unanimity on the fact that all of our employees, whatever their jobs, have a role in driving that growth. I am particularly grateful to the presidents of the American Postal Workers Union, the National Association of Letter Carriers, the National Postal Mail Handlers Union, and the National Rural Letter Carriers' Association for their support, encouragement, and ideas in this area.

Our entire team is ready to make the new law work for us and for our nation. We are acting quickly to use its new approaches to produce the revenue that can close the remaining \$1 billion of our budget gap. Even though the new law permitted us one final price-adjustment cycle under the provisions of the 1970 law, the inordinate length of that process would not have produced additional revenue before the middle of our next fiscal year. Frankly, we could not afford that.

Neither could our mailers. In our conversations with them, they made it clear their preference was for smaller, regular, and more predictable price changes. This allows them to better plan and budget for mailing expenses, avoiding the "sticker shock" many of them experience when they must absorb larger price increases every two or three years. Consistent with the intention of the new law, we plan to adjust rates each May.

Our decision to adjust rates on May 12 for our market-dominant products – First-Class Mail, Standard Mail, Periodicals, and Package Service – is projected to produce about \$735 million in additional revenue through the end of this fiscal year. Prices for these products will increase by an average of 2.9 percent at the class level, conforming to the law's requirement that they not exceed the rate of inflation as measured by the Consumer Price Index.

In some service categories, prices will remain the same or will actually go down. For example, there is no change in the additional-ounce rate for single-piece First-Class Mail. There is a new, lower additional-ounce price for some presorted First-Class letters. The pound price for Standard Mail saturation and high-density flats will be lower than the current rates. And through the new price structure, we have continued to simplify our international services, aligning them more closely with domestic products, making it easier for customers to select the prices and services that best meet their needs.

The law requires the Postal Service to operate in a more businesslike way than had been possible under the restrictive provisions of the old law. We recognize that pricing innovation – even within the limits of a well-defined rate cap – is a key business driver. With that in mind, we are taking full advantage of our new pricing flexibility to grow business.

We could not have acted so quickly without the diligence of the Postal Regulatory Commission and its Chairman, Dan Blair. Although the law did not call for the Commission to develop new pricing regulations before June 2008, its members made this a priority and worked closely with the mailing community to understand its needs and preferences.

The Commission's completion of this complex and critical task in October, well ahead of schedule, put the Postal Service in a better position to weigh its needs against the new and the old pricing regulations, permitting us to make a decision that will have a significant and positive impact on our bottom line in the current fiscal year.

Taken together, the additional cost reductions of \$1 billion, combined with the \$735 million in increased revenue from the coming price adjustment, can reduce our projected 2008 loss from \$2 billion to \$265 million.

We have taken a realistic look at immediate-term growth opportunities, both in core, market-dominant products, and in competitive products – such as Express Mail, Priority Mail, and Parcel Select. We believe that over the next seven months we can and we will exceed the revenue that will be produced by the coming price adjustment and more than meet the \$1 billion we have added to our revenue target.

We are now finalizing a new price structure for our competitive products category and expect to announce it sometime next month. Unlike market-dominant products, prices in this category are

not linked to the CPI cap and can be aligned more closely with the needs of customers and the dynamics of the marketplace.

In the meantime, we are enhancing our Express Mail and Priority Mail products so they provide even greater customer value. We are expanding the range of the Express Mail guaranteed overnight network to include even more ZIP Code destinations. We are providing additional scanning as Express Mail moves through the network, providing customers with the enhanced tracking information they are requesting.

Unlike similar products offered by competitors, Express Mail offers Saturday delivery at the regular weekday delivery price. And the Postal Service is alone in offering Sunday and holiday delivery of this guaranteed overnight delivery service. The new premium pricing – which matches other shippers Saturday delivery surcharges – reflects the premium delivery option the Postal Service provides on Sundays and holidays. These are services that are not available from other providers at any price.

Responding to the needs of commercial shippers, we have introduced a new, larger Priority Mail Flat-Rate box. We have also made it easier for friends and families to bring a touch of home to their loved ones serving at overseas military addresses with a two-dollar lower price on the new Flat-Rate box. This is a first, something that was not possible under our previous pricing regulations.

We have just scratched the surface of the advantages the new law offers through its new approach to price setting. I have challenged everyone in the organization to bring their ideas to the table. They are responding with energy, with creativity, and with a commitment to making our services the services of choice for every mailer and every shipper.

Our preparations over the last year have also included addressing the multiple new review, policy, and reporting requirements established by the law. Some were the sole responsibility of the Postal Service. For others, we provided cooperation and assistance to the agencies that were assigned primary responsibility.

Soon after the law's enactment, we instituted a new nationwide policy to implement the changes it mandated to the workers' compensation program for employees.

By early spring, we had completed a review and assessment of our existing purchasing regulations. We found that they met the intent of the law as it relates to the use of commercial best practices and fair treatment of suppliers. The law recognizes the positive business value of these approaches to purchasing the supplies and services that support a nationwide mail processing, transportation, and delivery network. Through innovative practices such as national pricing agreements and reverse auctions, we can seek the best value – a combination of price, quality, availability, and service. This helps minimize our costs and limits growth in the price of postage, ultimately benefiting every postal customer in every community. Last year, using these approaches, our cost for supplies and services – at \$2.6 billion – was \$49 million less than the previous year.

Another issue we examined last year was the retention, handling, and release of data that may be relevant to legal and judicial activities. As a result we developed data retention policies that are now standard throughout the organization. These are supported by well-defined procedures that we will follow in response to subpoenas.

The independent Office of Inspector General of the Postal Service submitted its report on workplace safety to the President, Congress, and to Postal Service management. We were extremely pleased by its conclusion that “. . . the Postal Service established and exceeded its OSHA I&I (Injury and Illness) reduction goals . . . .” In November, we provided Congress with our response to this report.

We also reviewed our international operations from the perspective of customs practices. As a result, we have created a plan for the effective implementation of customs requirements throughout the system.

By September, we developed and submitted our initial Mail Classification Schedule to the Postal Regulatory Commission. This was a critical step in the delineation of the distinctions between our market-dominant and competitive products categories.

The requirement that the Postal Service develop modern service standards and the supporting service measurement systems for market-dominant products is among the most far-reaching activities called for in the new law. By November, we provided the Postal Regulatory Commission with an outline of our approach to service measurement, beginning an important conversation on this subject. In December, after months of consultation with the Commission, we published our modern service standards.

The new standards take into account the current capabilities of our mail processing and transportation networks, as well as changes in mailer behavior – such as worksharing and entering mail deeper into the postal system – that can have a material effect on the amount of elapsed time from mailing through delivery. The input of mailers representing virtually every element of the mailing community was an ongoing and integral part of this process. This cooperative effort contributed to the development of service standards that meet the needs of customers as well as the Postal Service.

New service-measurement systems will help drive the achievement of the new service standards when implemented. Through conversation and consultation with the PRC, we have agreed in principle to the creation of a measurement system that joins independent, third-party measurement activities – essentially an expansion of today's independent External First-Class Measurement System – with robust internal measurements made possible through the implementation of the Intelligent Mail Barcode.

The new barcode will become mandatory in 2009 for mailers who take advantage of automation prices. Its use will allow us to combine a system that physically measures a limited, but statistically valid, sampling of our daily mailstream to one that passively measures an exponentially greater volume. For example, in December, with slightly more than 400 mailers participating, we collected more than one-billion Intelligent Mail Barcode scans. During the same period, our external, third-party system measured 250,000 pieces of mail.

The mail-flow data we collect will be the basis for a wide range of reports that customers can obtain and that can also serve as important diagnostic tools for the Postal Service. We believe this system represents the ideal synthesis of both systems – actual performance data measured in real-time as mail moves through our network, plus the validation offered by external sampling.

A second report by the Office of Inspector General, in November, addressed the adequacy and fairness of the Postal Service's process for the determination and appeal of Nonprofit rate mailings. The OIG's report found that "the assessments and appeals process was adequate and fair," and found no compelling reason for Congress to assign an outside body a role in the process. The OIG also determined that there was no need to establish a statute of limitations because of our existing 12-month time limit for revenue deficiency assessments. In the areas where it was recommended that we update and clarify our instructions, we agreed to do so.

The following month, the Postal Service's Board of Governors completed two workplace-diversity reports that were submitted to the President and to Congress. One addressed diversity within our management ranks and the other focused on purchasing contracts with minorities, women and small businesses.



The Board reported that although the total number of Postal Service employees has decreased since 2004, the representation of female and minority employees has increased steadily. Over the three-year period covered by the report, the percentage of Hispanic, Asian American Pacific Islander, Black, and White females in supervisory and managerial positions has increased.

The Board was also clear about its ongoing commitment to building strong relationships with small, minority-owned, and women-owned businesses. This commitment is reflected in the creation of a new *Supplier Diversity Corporate Plan – Fiscal Years 2007-2010*, which underlines the fact that supplier diversity is a proactive business process with the goal of providing suppliers with access to purchasing and business opportunities. The number and value of these contracts are tracked quarterly and annually, with sourcing and commodity strategies adjusted as necessary. In fiscal year 2007, the combined value of contracts with small businesses, minority-owned businesses, and women-owned businesses was \$4.4 billion.

In recognition of our efforts to establish and maintain a strong, competitive supplier base that reflects the diversity of the supplier community, DiversityBusiness.com named the Postal Service as the Top Organization for Multicultural Business Opportunities and one of America's top diversity advocates.

Also in December, the Department of the Treasury submitted its recommendations to the Postal Regulatory Commission on the accounting practices and principles that will be used to separately account for our market-dominant and competitive products.

The Treasury's recommendations addressed our cost-attribution systems; the creation of a theoretical Postal Service competitive enterprise; the creation of a corresponding theoretical income statement using existing financial systems; attributable costs and cross-subsidization; the validation and adjustment of the costs of our universal service obligation; line-of-business costs and institutional costs; the use of a simplified approach for calculating federal income tax; and, sufficient independent review of supporting information.

Our review of the Treasury's recommendations indicates that they are consistent with our approaches to these issues. When completed and implemented, they will provide for a full and fair accounting for all costs and prevent any financial cross-subsidization of competitive products by market-dominant products.

At the same time, the Government Accountability Office issued an interim report to Congress on Postal Service and mailing industry mail-related recycling. The report found that the Postal Service, the mailing industry, and other stakeholders have undertaken numerous mail-related recycling programs, but could not quantify the extent to which these initiatives have been undertaken. The report lists several innovative stakeholder-identified opportunities to enhance recycling efforts but cautions that they must be considered within the context of mission compatibility, logistics, and cost. The GAO expects to issue a more comprehensive report in the spring.

In the meantime, the Postal Service will continue to plan, execute, and improve programs – internally and with industry partners – to minimize the impact of the mail and postal operations on every aspect of the environment. It is our goal to be a positive environmental influence in every community that the Postal Service calls home. Our investments in recycling, energy conservation, "green" vehicles, and "green" buildings continue to be recognized as innovative and effective. For the Postal Service, sustainability is more than just a concept – we are making it a way of life.

We submitted the initial version of our Annual Compliance Report to the Postal Regulatory Commission in late December. It includes data on product costing methodologies, service performance, and customer satisfaction. Because the Report covers fiscal year 2007, it is largely transitional in nature, as price setting during that period was governed by the provisions of the Postal Reorganization Act of 1970, not the Postal Act of 2006. Similarly, data contained in the report is primarily based on what has been filed in the past, in accordance with the requirements of the 1970 law.

As the Commission completes its rulemaking addressing the Annual Compliance Report, we make appropriate adjustments to its content and the sources of information that we will use. We anticipate filing our first official Annual Compliance Report this December.

Among the significant changes resulting from the new law is the requirement that the Postal Service comply with Securities and Exchange Commission rules that implement the financial internal controls under Section 404 of the Sarbanes-Oxley Act of 2002. We must also obtain an opinion regarding the effectiveness of Internal Controls over Financial Reporting from the Board of Governors' external audit firm. The Postal Service is the only federal agency with this obligation and we are on track to meet full compliance requirements by 2010.

To prepare for this, the Postal Service is following best practices and guidance published by the Public Company Accounting Oversight Board (PCAOB) and the Securities and Exchange Commission (SEC). We have established a top-down, risk-based approach to identifying, assessing, and reporting internal controls that can affect our financial reporting. We are also using the framework established by the Committee of Sponsoring Organizations, and which is approved by the SEC and PCAOB, to assess the key components of our internal controls.

In 2007, we achieved several key milestones in complying with the Sarbanes-Oxley requirements. We identified the systems and financial business processes that will fall within the scope of our efforts. We established an active SOX Steering Committee and Program Management Office. We targeted opportunities for business process improvements. And we are evaluating and assessing the key internal controls over financial reporting, allowing us to identify and resolve any discrepancies.

Earlier this month, we filed our first 10-Q Quarterly Financial Report with the Postal Regulatory Commission. Regular quarterly reports will follow, beginning in May. We will file our first 10-K Annual Financial Report in November.

Over the years, there has been considerable discussion about whether the Postal Service's status as a government organization provides us with an advantage – or a disadvantage – in the competitive marketplace. In an effort to provide a quantitative answer to this question, the new law directed the Federal Trade Commission to prepare a report regarding the federal and State laws that apply differently to the Postal Service than to the private companies that provide services similar to those in our competitive products category.

The FTC's study was far reaching and detailed, including input from the Postal Service, leading private-sector delivery companies, the Postal Regulatory Commission, Government Accountability Office, other government agencies, mailers, postal unions, and members of the public. In examining economic burdens compared to what it terms "implicit subsidies," the report concluded that the Postal Service is burdened with a unique "net competitive disadvantage versus private carriers." This is based on the costs of meeting our universal service obligation, as well as other laws and regulations that apply to the Postal Service but not to other carriers. The report estimates that these differences incur costs on the Postal Service that may exceed \$550 million a year.

As I mentioned earlier, we will be implementing our first price changes using the new regulations on May 12. In the market-dominant product category, we have set prices carefully to satisfy the requirements of the law and to moderate the impact of the 2007 price changes for Standard Mail flats and Periodicals. Our proposed prices for these products, as filed with the former Postal Rate Commission in 2006, were in many cases less complex and below those recommended by the Commission in its decision of February 2007.

An important milestone established by the new law is the requirement that the Postal Regulatory Commission prepare a report on the Postal Service's Universal Service Obligation and the mail monopoly by the end of this year. These are important public policy questions that have been a rich source of study, conversation, and debate over the last several years.

The consequences of any proposals to modify our universal service obligation will be profound for every family and every business in every community throughout the nation. I believe the Commission's assignment – and the interests of the American people – can only be enhanced by its review and consideration of the existing body of work in these areas. On behalf of the Postal Service, we look forward to working with the Commission as it undertakes this important task.

Over the course of this year, the Postal Service will continue to break new ground as it implements innovative pricing structures for our competitive product category. They will reflect the flexible approaches now available through the new law and we expect to be announcing them soon. Our efforts are intended to make these products more attractive by providing shippers with incentives and other approaches that are common throughout the shipping industry, and that we have designed to support growth and profitability.

In many ways, the potential for growth remains largely within our control. It will be dependent on continued strong service, easy and convenient access, products that meet today's customer needs and anticipate those of tomorrow, the effective use of new pricing tools, and, of course, effective marketing and sales efforts – formal and informal – by every one of our employees in every part of our organization.

As we align our efforts with the regulations developed by the Postal Regulatory Commission, we need to continue to work with the Commission to ensure that the new regulations do not unnecessarily impede our ability to negotiate customized pricing and service arrangements with individual mailers – both in the market-dominant and competitive product categories. The intent of the new law was to remove the barriers that prevented the Postal Service from going to market quickly. But the prospect of an open-ended regulatory proceeding before any customized agreements could become effective can create uncertainty in the minds of our customers as to our ability to negotiate agreements that can, ultimately, be implemented.

An additional issue with this procedure is maintaining the confidentiality of the terms of a specific agreement – a common practice throughout today's business world. We are hopeful that we can continue to work with the Commission to resolve these issues in such a way as to fully capture the potential for creative and profitable customer arrangements embodied in the new postal law.

In pursuing growth, we also see tremendous opportunity in international products. We have improved our network, simplified product offerings, and made it easier for mailers to navigate complex customs and other processes that have served as impediments to expansion in the past. We appreciate the cooperation of our partners – other federal agencies, foreign postal administrations, the International Post Corporation, and the Universal Postal Union – in helping us to create an environment that supports the efforts of American businesses, large and small, to take advantage of international markets.

While we have benefited from changes in foreign exchange rates – a situation we cannot depend on in the long term – it is no surprise that good service sells. Our international mail volume has

grown by 18 percent over the last two years. We are working to position ourselves to continue strong growth in this product line.

Overall, the outlook for our international products is encouraging. Yet there are a number of situations that do cause us concern that we cannot resolve independently.

The first of these involves international air transportation. Today, the rates we pay air carriers for this service are governed by Department of Transportation regulations. Generally, we cannot negotiate rates based on market conditions, volumes, performance or other variables that are taken for granted in negotiating rates for the ground and air transportation of domestic mail.

Put in its simplest terms, a law that requires us to move toward even more businesslike management practices has placed us at odds with another law that, in this instance, prevents it. As we begin operations under a price cap that affects the lion's share of our business, we must find ways to reduce these and other costs.

We must also consider their effect on the customers who ultimately bear these costs. For example, the Department of Defense, one of the largest volume users of international air transportation for mail to APO and FPO addresses could have saved some \$200 million over the last decade had we been able to negotiate with carriers. As we consider the needs of our national defense and the men and women of our armed forces – particularly during this time of conflict, it appears clear that this money could have been far better spent.

We have been discussing this issue with a number of air carriers and are hopeful that we can reach a consensus that supports the change to a negotiated rates solution. With such a system in place, the Postal Service could have benefited from approximately \$500 million in cost avoidance over the last 10 years.

This limitation can only be removed through the efforts of Congress in introducing and enacting legislation that would permit negotiated rates for international air transportation.

A second issue of concern regarding international mail involves the entry of material generated by American businesses or government agencies directly into the mailstreams of foreign postal administrations. For example, an American business may prepare a mailing for customers or potential customers with addresses in Mexico. The originator would bypass the United States Postal Service and work through a third party to pay Mexican postage and deposit the mail through Mexico's Post Office.

The third parties can be other foreign posts, such as Germany's Deutsche Post, or private businesses that maintain a presence in Mexico or other nations for this purpose. When the third party is another postal administration, this type of office is known as an Extraterritorial Office of Exchange (ETOE). This is a legitimate practice and one sanctioned by the Universal Postal Union.

Unfortunately, our experience has shown that the activities of some foreign posts and consolidators can result – inadvertently or otherwise – in lost revenue and increased costs for the United States Postal Service.

This often occurs when material entered through foreign posts is returned to its American originator through our mail system because it is undeliverable as addressed. However, because it did not originate as United States mail with United States postage, we incur added costs for its return. The actual mailer, the foreign-based ETOE or consolidator, should be the recipient of the returned mail and responsible for its costs.

But in many instances, the return address on the mailpiece identifies only the originator of the mail in the United States, not the actual sender, incorrectly leading to the assumption that the item began its journey as U.S. Mail.

In other cases, the ETOE or consolidator improperly uses Universal Postal Union forms and coding to suggest that the material was mailed through the United States Postal Service. We have also found that some may use our mail containers when presenting this material to a foreign postal administration, again suggesting that the material was mailed in the United States.

Payment for the reciprocal exchange of mail between nations is governed by a system of international tariffs known as "terminal dues." When material is misidentified as United States Mail, it can skew the actual mail volumes involved, reducing payments due to us or increasing our payments to other posts.

A third situation occurs when an ETOE or consolidator deliberately misdirects its products to the wrong country. For example if an entity operating in the United States does not have a shipment of sufficient weight to a destination country, it may deliberately ship its material to a country to another nation for which the weight threshold is satisfied. If that occurs, the receiving country may forward the shipment to the actual destination country at the expense of the United States Postal Service.

Perhaps a more serious consideration is the fact that United States screening and safety standards, designed to enhance homeland security, may not be employed by ETOEs or consolidators. This means that material improperly reentering the United States as mail has not been subject the same rigorous scrutiny as international mailings actually initiated through the United States Postal Service.

We are working to address our concerns through other posts and the Universal Postal Union. These efforts can be enhanced through increased awareness among federal agencies that utilize third-party international mailings as well as the creation and application of stronger standards for operators who maintain a presence in the United States. Your understanding and support of our efforts can be of tremendous assistance and avoid unnecessary costs for American mail users.

Before I close, I want to acknowledge the work of Comptroller General David Walker over the last decade as the Postal Service intensified its efforts to become more effective and more efficient than ever. Mr. Walker understood that the ultimate transformation of the Postal Service was not simply an organizational issue; it was a critical public policy issue. He understood the need for new legislation that would provide the Postal Service with the flexibility necessary for success in a radically changed and dynamic business environment. I offer Mr. Walker my best wishes as he moves on to a challenging new phase of his career.

We are entering a period of profound change. Through the new postal law you have provided us with a new ability to navigate that change. As we begin this journey, I am grateful for your continuing support of a sound and financially independent Postal Service.

I would be pleased to answer any questions you may have.

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