UNITED STATES
POSTAL SERVICE

STATEMENT OF
SENIOR VICE PRESIDENT, OPERATIONS
WILLIAM P. GALLIGAN
SUBCOMMITTEE ON FEDERAL WORKFORCE, POSTAL SERVICE,
AND THE DISTRICT OF COLUMBIA
OF THE
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM
HOUSE OF REPRESENTATIVES
WASHINGTON, DC

JULY 26, 2007

Good afternoon, Mr. Chairman and members of the Subcommittee. I am pleased to be with you today. I will be discussing the Postal Service's continuing progress in effectively managing the evolution of our mail processing network to promote efficiency, manage costs, and protect the high levels of service it provides for our customers. I will also touch upon efforts to update our service standards and performance measurement systems.

My name is Bill Galligan. As the Postal Service's Senior Vice President for Operations, I have overall responsibility for engineering, facilities, delivery and retail operations, and, most relevant to our discussion today, network operations. There is a close and interdependent relationship between each of these activities which, ultimately, have a strong influence on the shape, effectiveness, and efficiency of our end-to-end operations.

Engineering is responsible for the development, deployment, and maintenance of the advanced mail processing technology that has made the United States Postal Service the most productive in the world. Engineering's efforts reflect a keen sensitivity to the ability of our existing facilities to accommodate state-of-the-art equipment, to the processes and work flows that contribute to achieving the most efficient equipment utilization, and to changes in mail usage patterns that will guide the development of future generations of equipment.

With a national processing, distribution, retail, and delivery network comprising almost 37,000 leased or owned sites, the Postal Service relies on its facilities group to identify, acquire, and maintain the buildings that provide optimal support for a wide range of specialized requirements, from the smallest Post Office to the largest mail processing center. An important goal of this group is securing facilities that provide the long-term flexibility necessary to accommodate changes to work flow, processes, and equipment that can occur over time.

Delivery and retail is responsible for development of the policies and programs that govern the operation of the nation's largest retail network and the delivery of 213 billion pieces of mail to more than 146 million households and businesses annually. Day-to-day operation of our retail and delivery units is the responsibility of our field operations organization, including our nine Areas and 80 Districts.

Network operations, through its ongoing partnership with each of these groups, is responsible for developing and maintaining an efficient and cost-effective national network of transportation, mail processing and distribution support. Managing these networks requires a constant adaptation to changing situations and requirements. These include shorter term adjustments arising from catastrophic events such as Hurricane Katrina, the anthrax crisis, and the 9/11 terrorist attacks. Longer-term structural adjustments can result from changing space needs; improvements in processing equipment; shifting population centers; mail volume fluctuations and declines; changes in mailer behavior, such as greater levels of presorting, and the deposit of mail deeper into our system; and the development of new strategies to improve efficiency and service.

In the simplest of terms, the role of network operations represents the core of a multi-step value chain. It begins with the local collection of First-Class Mail deposited into our system at Post Offices, street collection boxes, residential mail receptacles, or from community businesses, and its transportation to a centralized processing facility, generally called a plant. Commercial mailers with larger volumes usually deposit their mail right at the dock of the processing facility.

At the plant, stamped mail, a relatively small and declining percentage of our total mail volume, receives a cancellation and a postmark. The majority of mail, with paid postage represented by a printed permit or a postage-meter indicia, bypasses these initial operations.

Based on its characteristics and ultimate destination, the mail is then directed to different sorting operations. Mail for local delivery can be sorted to the delivery office, the various carrier routes within a delivery office, and the actual sequence in which mail is delivered on the route itself. This mail is later transported to the local delivery office for next-day delivery.

Mail for delivery to more distant points may be sorted by state, city, or three-digit ZIP Code prefix. For destinations with service standards that can be met by ground transportation, this mail is trucked to a destinating mail-processing plant. If standards cannot be achieved through ground transportation, First-Class Mail is flown to the destinating plant.

At the destinating plant, the incoming mail is commingled with other mail for similar destinations – whether generated locally or from longer distances – and sorted, as in our previous example, to the appropriate delivery office. From there, local transportation brings it to the delivery office for final delivery. Based on our established service standards – generally reflecting the distance from mailing to delivery points – non-locally-generated First-Class Mail is delivered on the second or third day after mailing.

Other types of mail, including bulk First-Class Mail, bulk Standard Mail, and Periodicals, normally experience some variation on this basic processing model. This may include movement through different types of processing facilities, and the bypassing of many Postal Service processing and transportation operations due to entry of mail as close to the delivery point as possible.

Our processing and distribution network, as it exists today, is the product of an evolutionary process that began when the system was created more than 230 years ago. Over that period, it expanded to serve a nation that was growing in population and territory. It adapted its infrastructure, from one that was developed to serve a largely rural nation, to one that was increasingly defined by its urban areas, and, in the years since the Second World War, to the rapid growth of suburbia and, more recently, "edge cities".

In the earliest days of our system, when absolute and per capita mail volume was relatively low, postmarking and mail sorting occurred at each individual Post Office. In the mid- to latter-nineteenth century, mail volume growth began a sharp and steady increase. Among the causes were the rapid expansion of our economy, the establishment of uniform and affordable national postage rates, the introduction of the prepaid postage stamp, and the inauguration of carrier delivery service. The burgeoning mail volumes – and the fact that more mail than ever was traveling longer distances – made it increasingly impractical and costly to process and sort mail in such a decentralized manner.

In the larger cities, a new concept, the General Post Office, resulted in the construction of larger, multi-purpose facilities. In addition to providing local mail service, they also served as central mail processing points, achieving the economies of scale that were impossible to realize through a network of much smaller offices with only a small fraction of their capacity.

The General Post Office was often co-located with a city's main rail depot, providing unimpeded access to mail volumes that were carried by the railroads – which had become the nation's primary and fastest form of long-distance transportation. This avoided the delays resulting from congested urban street traffic in moving mail back and forth between a more distant railroad station and the Post Office.

While the rails transported bulk quantities of mail quickly, it still had to be processed when it reached the terminal Post Office. This changed with the establishment of the Railway Mail Service, permitting mail to be sorted in special cars as they moved along the route, with pouches dropped off for local delivery at intervening towns as the train sped through. Locally generated mail was picked up from towns on the route. By the time the train reached its terminal, mail that had been sorted along the way was commingled with other mail already sorted and quickly sent along to its destination, across the city or across the nation. By 1930, their peak year, more than 10,000 trains moved the mail.

Only 35 years later, this number was less than 200. And by 1977, the Railway Post Office – and for the most part, the commercial elements of our national passenger rail system – were history. One of the backbones of our processing and distribution system for a better part of a century, the railroads could not overcome the transportation advantages offered by progress in air transportation and a modern interstate highway system.

At the same time, a strong and growing economy altered consumer behavior substantially from the "make-do" Depression and war years. Decades of pent-up consumer demand resulted in levels of purchasing never before imagined. Increasingly sophisticated advertising and direct mail industries became critical links between consumers and sellers. And new financial tools, like consumer credit cards, offered an unheard of degree of flexibility to everyday buying activities. These activities resulted in a new reliance on the mail – for selling, shipping, and billing.

This contributed to a steadily-growing mail volume and the need to find more efficient ways to process mail volume that registered record growth year after year. Advances in mechanized mail processing and sorting made it possible to increase efficiency by concentrating resources – including new equipment and employees – at a fewer number of larger facilities that, because of their size, offered the flexibility necessary to accommodate new equipment.

At the same time, suburban growth placed new demands on developers, local governments, and the Postal Service to provide services to the families who were moving into new subdivisions far from the city centers. As the new communities were served by new and improved highways, new schools, innovative shopping centers, and of course, extension of mail delivery, demand for additional housing increased, creating more than a half century of unparalleled suburban and exurban development.

Mail volume continued its seemingly unstoppable growth. Coupled with suburbanization and the development of the automated processing equipment necessary to absorb burgeoning mail volume without sharply increasing staffing and compensation costs, the Postal Service took a new approach to mail processing.

In most cases, the existing General Post Offices could not readily accommodate the needed new equipment. Nor could their locations, most often in downtown areas, accept the vastly increased truck traffic necessary to bring mail to and from what had often become sprawling bedroom communities and more distant airports.

Over the last four decades a network of centrally-located mail processing facilities was developed and constructed, located to take advantage of the proximity of highways and airports. They were designed specifically to maximize efficient mail flow, equipment utilization, and the economies of scale generally not possible in smaller, older, multi-level facilities that were insufficient for the space needs of modern processing equipment and their supporting conveyor, containerization, and transportation systems. In some cases, these newer facilities could accommodate up to 200 trucks at a time, rather than the much smaller number, often no more than a dozen, possible in core city locations.

When the modern, self-supporting Postal Service was created by the Postal Reorganization Act of 1970, more than 2,000 facilities served as our primary, outgoing mail-processing locations. Today, that number has been reduced to less than 400. Most mail processed in our nation today moves through one or more of these facilities. In fact, virtually all mail generated in the cities and towns of America is today processed at a centralized mail processing facility, along with mail from hundreds of surrounding communities. This has been the practice for decades. It is the exception that locally-generated mail is processed at the local Post Office.

Our flexible network approach has allowed us to keep pace with the needs of a changing nation. It has supported improvements in process consistency, equipment standardization, the economies of scale, and the achievement of record service performance and customer satisfaction. But the fact that our network has evolved into the form it occupies today should not be taken to mean that this is its ideal configuration.

The key fact that must be taken into consideration as we examine the future of our processing and transportation networks is that the dynamics of the 21st century communications market have altered – forever – the basic assumptions of postal economics in a monopoly environment. The traditional postal monopoly, while it still exists as a matter of theory and law, particularly for what the Postal Accountability and Enhancement Act of 2006 terms our "market-dominant products," does not exist in actual practice.

The explosive growth of electronic communications and an intensely competitive package delivery sector have led to the diversion of messages, business and financial transactions, and packages from the mail channel. Competition exists for every piece of mail that moves through our system.

This has significantly slowed overall volume growth, with actual declines in some products, and resulted in shifts from higher-margin products such as First-Class Mail – which represents 50 percent of our revenue base – to products like Standard Mail, which make a lesser contribution. However, Standard Mail volume is not growing at a rate sufficient to offset the decline in First-Class Mail. And our projections give us no reason to believe that First-Class Mail volume will rebound.

In a practical sense, this means that mail volume growth can no longer match the historic trends of the last three decades. In fact, we are projecting an absolute decline of one billion pieces of mail during the current fiscal year. At the same time, we will incur the expense of expanding our delivery network to accommodate almost two million new homes and businesses each year. On average – even with the recent rate change – we are delivering fewer pieces of mail to each address and average revenue per delivery is decreasing.

The business model created by 1970's Postal Reorganization Act to sustain a self-supporting Postal Service had as its basic assumption that continued growth in mail volume would produce the revenue necessary to offset the costs of an ever-increasing delivery base. That model is broken because mail volume is no longer growing at a rate sufficient to sustain delivery expansion.

While the Postal Accountability and Enhancement Act does respond to the Postal Service's need for flexibility in key areas such as price-setting and product differentiation, it does not fix the broken business model. However, with its stress on our ability to balance costs and the prices we charge for our services, the Act severs the historic linkage between our revenue requirements and our rates. By law, we are now required to keep prices at or below the rate of inflation for market-dominant products, which represent over 90 percent of our revenue base. Unfortunately, our costs are not governed by this same standard and many, such as energy and health benefit costs, have been rising faster than the consumer price index.

This is not a formula for long-term success. The challenge is to close the gap between prices and costs while maintaining quality service. The question is, "How do you do that?" As Postmaster General John E. Potter testified before this Subcommittee last week, management can proceed along any of the following three paths.

The first is operating as we have been since the Postal Reorganization Act of 1970 created today's Postal Service. It is difficult to argue with the success that it has engendered, particularly in the areas of service and efficiency improvements, and moving from a heavily subsidized to a self-supporting organization that has met its financial "break even" requirement.

But the rate cap imposed by the Postal Accountability and Enhancement Act of 2006 has changed the ground rules. Taking a "business-as-usual" approach would conflict with our responsibilities under the new law: we no longer have the option of adjusting rates to compensate for rising costs. Managing responsibly means that our focus has to be on keeping overall cost growth at or below the rate of growth in the consumer price index.

A second path to closing the gap between our costs and our rates would be the wide ranging outsourcing of duties now performed by our own employees. From a balance-sheet perspective, this could have a considerable effect on helping to reduce our costs. But it does not come without other costs that could affect our business success by interfering with our focus on working together to provide our customers with the best service possible.

We prefer a third, more inclusive path, one that involves working cooperatively with our unions and other stakeholders. We believe this is the best way to understand and address the issues that affect all of us, such as growing revenue and reducing costs. Our collective experience and ideas can be greater than those of each of us individually, resulting in the best approaches to the challenges we are facing.

I believe this approach is directly applicable to the actions we have been taking in response to the changes that are – and will continue to be – affecting our mail-processing network. They involve changes in the mail volume and mail mix handled by our processing facilities, changes in how mailers prepare and tender their mail, and the acquisition of new technology designed to increase accuracy and efficiency.

Since 1998, the volume of single-piece First-Class letters entering our system has declined by almost 14 billion pieces, or 25 percent, and this erosion continues by about 1.5 billion pieces annually. This is a very disturbing trend, particularly when viewed within the context of the average daily mail volume of 700 million pieces that moves through our system. Without offsetting adjustments, this volume erosion reduces processing efficiency and negatively affects our bottom line.

Bulk First-Class, Standard, and Periodicals mail, because it is largely presorted, can bypass many of our processing operations, resulting in greater efficiency for the Postal Service. This is not the case with single-piece First-Class letters, which require far more handling as they move through our facilities, resulting in higher per-piece processing costs.

Our investments in high-speed canceling, barcoding, and sorting technology was intended to maximize processing and distribution productivity for this mail, minimizing processing costs and achieving optimum return on our equipment investment. However, in many locations this equipment is no longer processing the intended volumes, resulting in productivity declines, increased costs, and a diminished return on investment.

The erosion of single-piece First-Class Mail represents two trends in changing mail use, which affect our processing network. The first is the decline in total First-Class Mail volume, which fell from a peak of 107 billion pieces in 2001 to 98 billion pieces last year. The second is the shift on the part of many mailers from single-piece First-Class Mail to less-expensive workshare-rate bulk First-Class Mail. In 2005 alone, this shift resulted in a $300 million revenue decline.

The growing shift to presort mail permits mailers to take advantage of rate incentives that encourage depositing this mail much closer to its final delivery point. In some cases, this mail is entered at the actual delivery office. In other cases, it may be entered at the local processing plant serving the delivery office. Either way, this mail bypasses most of our "end-to-end" processing operations, the plants in which they are located, and the transportation networks that link them together.

In 1970, virtually all mail was entered into our system where it originated – an acceptance facility in the vicinity of the location where it was prepared by the mailer. That has changed appreciably in the intervening decades, dramatically shrinking the use of our network. Today, approximately 40 percent of the mail we handle no longer requires end-to-end transportation. We expect this overall trend to continue.

Both the decline in single-piece First-Class letters and the entry of more mail deeper into our system means that our network, as it exists today, is not aligned with our current and anticipated future needs. The resulting excess mail-processing and transportation capacity drives unnecessary costs challenging our ability to successfully operate within the limits of a statutory rate cap.

Given this challenge, we cannot afford to let our processing operations become less productive, something that will occur if we maintain the shape of the current network. It is imperative that we reduce overhead costs sufficient to offset declines in mail volume and fundamental changes in how mail moves through our system. This is why we must have the ability to adjust our infrastructure to reduce excess capacity, duplicative processes, and their associated costs. These necessary system adjustments will contribute to our ability to keep cost growth at or below the rate of inflation, balancing the requirement that rate increases do not exceed the rate of inflation.

A third important factor in the continuing evolution of our network is the pending deployment of the latest generation of automated mail sorting equipment, the Flat Sequencing System, for non-letter-sized items such as catalogs, magazines, and larger envelopes. While we have been successful in automating major elements of our mail processing, support, and retail functions, the physical delivery of hard-copy mail is not automatable. But, as we have learned through the progress in letter-mail processing, we can increase delivery efficiency through the automated sorting of mail into the sequence in which it is delivered by our delivery carriers. Reducing carrier in-office mail-preparation time can increase the time available for actual mail delivery, allowing us to better manage the costs associated with serving a growing delivery base and better respond to the financial pressures of reduced revenue per delivery.

Extensive testing of the Flat Sequencing System (FSS) in a live-mail-processing environment in Indianapolis has been successful. Phase one of a multi-phase deployment will begin in 2008, with completion anticipated by 2010. To the greatest extent practical, our goal is to integrate the FSS into select, existing facilities, based on the level of delivery volume, rather than to burden our ratepayers with the expenses of leasing or constructing new facilities. However, because of the very considerable space needs of this equipment, adjustment or relocation of some other processing operations, in some cases to other nearby facilities, may be required.

Today's processing and transportation network is the product of a continuing evolution based on a wide range of factors that affect our business. And, as we have seen, those factors can and do change over time. By continually improving our distribution and transportation systems, we have been able to achieve and maintain record levels of service, and customer satisfaction and unprecedented levels of productivity.

Despite these successes, some concerns have been raised regarding recent efforts to consolidate some mail processing operations in a number of locations through our Area Mail Processing concept. These adjustments are due to the decline in single-piece First-Class Mail, advances in automated mail-processing and distribution technology, and a growing shift in the entry of mail to locations much closer to the final delivery point. These adjustments generally result only in the transfer of a limited number of operations from one facility to another, not in the closure of affected facilities.

By combining the processing of this mail from multiple locations to a single, centralized location, we can reverse the decline in equipment efficiency resulting from reduced mail volume and daily throughput. We can reduce maintenance costs as we limit the amount of equipment requiring service. We can reduce the costs associated with obtaining new equipment as existing, underutilized equipment can be redeployed where it can be better used. And by reassigning employees from the affected operations – consistent, of course, with our obligations to them under the collective-bargaining agreements with our unions – we can minimize disruption to our employees' lives.

The Postal Service has been pursuing the Area Mail Processing concept for over three decades. This program has made it possible to decrease the number of outgoing processing locations by 80 percent, to fewer than 400. Our efforts today are simply a continuation of that process, accelerated by the extremely sobering imperatives of a radically- and rapidly-changing business environment. Over the years, the move to Area Mail Processing has not resulted in the layoff of a single, career Postal Service employee. This is not about to change.

Many of our stakeholders have raised a number of valid concerns regarding our implementation of Area Mail Processing initiatives over the last two years. As a result, we have revisited our policies, which have not been revised in many years, to address these important issues. Our revised policies, which will be issued shortly, will include well-defined public notice and public input processes, and increased transparency. What will not change are our continuing efforts to provide a network infrastructure that is more cost-effective and service responsive overall.

We discussed the key elements of our strategy to increase the pace of the evolution of a more efficient network in our original 2002 *Transformation Plan* and its successor *Strategic Transformation Plan 2006-2010*. In 2003 the bipartisan President's Commission on the United States Postal Service, in its report *Embracing the Future: Making the Tough Choices to Preserve Universal Mail Service*, issued a strong endorsement of our goal of streamlining our distribution network to reduce costs, increase operational effectiveness, and improve consistency of service. As you know, in the Postal Accountability and Enhancement Act of 2006, Congress endorsed this aspect of the Commission's work and strongly encouraged the Postal Service to expeditiously move forward in its network streamlining efforts.

In planning for today's hearing, the Subcommittee has also expressed its interest in the Postal Service's efforts to develop modern service standards and to measure our performance against those standards. Both of these requirements were established by the Postal Accountability and Enhancement Act, which recognizes that sound adjustments of the Postal Service's processing and transportation network depend upon accurate service standards and performance measurement systems for our market-dominant products. In turn, greater network efficiency will be the primary driver behind better service performance in the future. We have undertaken a wide range of activities to comply with the requirements of the new law in this respect.

First, we are working with a diverse group of stakeholders to examine existing end-to-end service-standards for our market-dominant products. This is helping us to identify which standards may be candidates for revision, based on factors such as changes to business rules, actual network capabilities, or the growth of worksharing programs since current standards were first established. This will provide the baseline information necessary to determine if modifications to some standards are warranted.

Our efforts involve the participation of the Mailers Technical Advisory Committee, in a main workgroup that involves over 100 representatives from all elements of the industry. This workgroup includes the participation of the independent Postal Regulatory Commission and the Government Accountability Office. We have also surveyed more than 35,000 small businesses and residential customers to help guide the development of the new standards. Outreach efforts also include interacting with attendees of the National Postal Forum, the leading annual mailing industry trade gathering, and briefings to our employee unions and management associations.

We are on target to complete this review – which will include proposed new service standards – by next month. This will provide us with sufficient time for required consultation with the Postal Regulatory Commission prior to the publication of revised service standards by late December 2007.

Our goal in developing these standards is to meet the needs of our customers while building from a base that is within the reach of the capabilities of our system. And, as we establish full accountability in achieving the new goals on the part of our managers, we believe that fairness dictates that we compile a full year's baseline of performance data under the changed standards prior to linking their performance evaluations to the achievement of the new goals. As an organization, however, we will bring all of our efforts to bear on meeting the revised service standards as soon as they are effective.

Just as important as the establishment of the new standards is the development and implementation of measurement systems to determine our compliance in meeting the standards. This is a subject that is also being examined by the Mailers Technical Advisory Committee.

Our efforts include planning for the possible use of the Intelligent Mail platform for accurate service performance measurement. Leveraging this internal, passive data collection system will allow us to accurately measure aggregate performance data – rather than sampling. We believe this is ultimately in the best interests of our customers, who ultimately pay for service measurement through the price of postage.

Our innovative Intelligent Mail system uses barcodes that uniquely identify each piece of mail for purposes of sorting, identifying special services, performing diagnostics as we identify system "pinch points," and providing status data to mailers. From the perspective of a passive service measurement system, the Intelligent Mail barcode will permit us to identify when mail enters our system, track the mail as it moves through the network, and tell when it has been delivered. As we expand Intelligent Mail to different types of mail, it can be used to accommodate service measurement needs. We anticipate full implementation of the Intelligent Mail barcode for most commercial mail in 2009. The Intelligent Mail barcode contributes to enhancing the value of the mail for our customers, contributing to their business growth and success, ultimately helping the Postal Service to achieve its critical goal of revenue growth.

We look forward to working with our stakeholders, particularly the Postal Regulatory Commission, in achieving agreement on the issues of revised service standards and measurement systems for our market-dominant products.

I appreciate having the opportunity to discuss these important issues with you today. I would be happy to respond to any questions you may have.

# # # #