CAN A USPS-RUN HEALTH PLAN HELP SOLVE ITS FINANCIAL CRISIS?

HEARING

BEFORE THE

SUBCOMMITTEE ON FEDERAL WORKFORCE, U.S. POSTAL SEVICE AND LABOR POLICY

OF THE

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM
HOUSE OF REPRESENTATIVES

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TUESDAY, MARCH 27, 2012

HOUSE OF REPRESENTATIVES
SUBCOMMITTEE ON FEDERAL WORKFORCE, U.S. POSTAL SERVICE AND LABOR POLICY,
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM,
Washington, D.C.

The subcommittee met, pursuant to call, at 9:35 a.m., in Room 2154, Rayburn House Office Building, Hon. Dennis Ross [chairman of the subcommittee] presiding.

Present: Representatives Ross, Amash, Issa (ex officio) Jordan, Gowdy, Lynch, Norton, Connolly, Davis and Cummings (ex officio).

Staff Present: Ali Ahmad, Majority Deputy Press Secretary; Michael R. Bebeau, Majority Assistant Clerk; Robert Borden, Majority General Counsel; John Cuaderes, Majority Deputy Staff Director; Adam P. Fromm, Majority Director of Member Liaison and Floor Operations; Linda Good, Majority Chief Clerk; Seamus Kraft, Majority Director of Digital Strategy and Press Secretary; Justin LoFranco, Majority Press Assistant; Jeffrey Post, Majority Professional Staff Member; Peter Warren, Majority Policy Director; Kenneth John, Majority Detailee; Jaron Bourke, Minority Director of Administration; Kevin Corbin, Minority Staff Assistant; Ashley Etienne, Minority Director of Communications; Angela Hanks, Minority Counsel; Jennifer Hoffman, Minority Press Secretary; Adam Koshkin, Minority Staff Assistant; and Adam Miles, Minority Professional Staff Member.

Mr. ROSS. Good morning. I would like to welcome everyone to the Subcommittee on Federal Workforce, U.S. Postal Service and Labor Policy. Our hearing today is, Can a USPS–Run Health Care Plan Survive its Financial Crisis?

I will call the Committee to order and begin with the tradition of Oversight Committee and its subcommittees with the mission statement of the Oversight Committee.

We exist to secure two fundamental principles: first, Americans have a right to know that the money Washington takes from them is well spent and, second, Americans deserve an efficient, effective government that works for them. Our duty on the Oversight and Government Reform Committee is to protect these rights.

Our solemn responsibility is to hold government accountable to taxpayers, because taxpayers have a right to know what they get from their government. We will work tirelessly in partnership with citizen watchdogs to deliver the facts to the American people and bring genuine reform to the Federal bureaucracy.

This is the mission of the Oversight and Government Reform Committee.

I will begin with my opening statement. After we do some opening statements, I may have to either suspend or turn the gavel over to run and do a vote over in Judiciary, but it would just be three to five minutes. I respect everybody's time and I am grateful that you are here.

I will now recognize myself for an opening statement.

A vibrant, healthy Postal Service is critical to our economy. Virtually everyone in the mailing industry, paper manufacturers, printers, catalog companies, and advertisers, rely on the Postal Service. These jobs, and many others, are directly tied to a healthy Postal Service. The mailing industry as a whole accounts for nearly 8.7 million employees and generates $1 trillion in economic activity each year.

Unfortunately, the United States Postal Service continues to inadequately respond to Americans' transition to digital communication and the related decline in first class mail volume, in large part due to an oversized workforce whose labor costs account for approximately 80 percent of the Postal Service's operating expenses.

As a result, today the Postal Service is facing the most significant financial challenge in its history and is on the brink of default, threatening the existence of hundreds of thousands of jobs all across America. Under the leadership of Postmaster General Donahoe, the Postal Service has made recent strides in improving the fiscal standing of the USPS. While I commend Mr. Donahoe for his commitment to implementing cost-cutting measures, the financial situation of the Postal Service remains untenable.

In response to this fiscal crisis, the Postal Service recently presented its five-year business plan to profitability. The USPS plan details a need to cut $22.5 billion in annual expenses by 2016 in order to keep pace with diminishing consumer demand for mail. The plan contains elements USPS can implement on its own and those that would require congressional approval.

The centerpiece of this plan involves shifting USPS employees and their retirees from the Federal Employee Health Benefits Plan, FEHBP, to a new USPS-run health plan. Today's hearing will examine many of the aspects of the Postal Service's business plan, and I thank the witnesses here today for testifying.

On a personal note, I do want to thank Mr. Donahoe, who I have come to deal with over the last 18 months and appreciate your efforts in trying to do all that you can to save the Post Office. When we met a couple of weeks ago, you indicated that you came from Pennsylvania and saw the occurrence of the rust belt, and that action there was not taken quick enough to save an industry. You are committed to saving this industry and I, along with you, am committed to saving this industry and making sure that the Post Office is around for well over another 200 years, that it is running efficiently, effectively at the service level the American public deserve and expect. So I thank you for being here.

With that, I will now recognize the Ranking Member of the full Committee, Mr. Cummings, for an opening statement.

Mr. CUMMINGS. Thank you very much, Mr. Chairman. I want to thank you for calling this hearing.

The Postal Service recently issued its five-year plan of profitability in which it proposes achieving $20 billion in savings by 2015. The Postal Service estimates that it can achieve $10 billion in cost savings without legislation, but it will require congressional action to realize the remaining $10 billion in savings.

According to the Postal Service's plan, the bulk of those savings, $7 billion, would be realized if Congress authorized the Postal Service to take its employees and retirees out of the Federal Employees Health Benefit Plan and put them into its own health care plan.

Currently, the FEHBP covers more than 9 million Federal employees and their families nationwide. Employees enrolled in FEHBP can choose from among 200 different health care plans. The Postal Service contends that it could manage employee health insurance better than the Federal Government as a whole.

I want the Postal Service to succeed in the long run. I believe the Postal Service serves a unique and irreplaceable function in our society; that it is a necessary part of our Nation's economic and social future. But I am quite skeptical that the Postal Service can or should manage its own health insurance system. I suspect that the achievable cost savings will come not from shrinking health care costs, but from shifting them onto employees. Postal employees would likely receive less coverage under the Postal Service plan and they would pay a greater share of their health bills. Postal annuitants would also pay more, as they would be faced with paying an increasing share of their health care from their fixed retirement incomes.

I look forward to hearing from the Postmaster today about his proposal and about these concerns.

I am also concerned with regard to the issue of possibly raising rates. One of the things that we have seen is a decrease in first class usage of the Postal Service. When we raise rates, which we may very well have to do, the question becomes will we continue to lose business. I think that is a very important thing that I know Mr. Donahoe will address.

I also want to hear from him as to how he is going to grow the Postal Service business and what new authority he needs from Congress in order to make the Postal Service as relevant to America's future as it was to our past.

So, Mr. Chairman, I want to thank you for your courtesy, and I yield back.

Mr. ROSS. Thank you, Mr. Cummings.

When Mr. Lynch, the Ranking Member of the Subcommittee, arrives, I will also allow him an opportunity to have an opening statement.

With that, members may have seven days to submit opening statements and extraneous material for the record.

We will now welcome our first panel. Mr. Patrick Donahoe is Postmaster General and CEO of the United States Postal Service.

Mr. Donahoe, as you are aware, pursuant to Committee rules, all witnesses will be sworn in before they testify. If you don't mind, please stand and raise your right hand.

Do you solemnly swear or affirm that the testimony you are about to give this Committee will be the truth, the whole truth, and nothing but the truth?

[Witness responds in the affirmative.]

Mr. ROSS. Let the record reflect the witness answered in the affirmative.

Thank you. As you know, your written testimony is before the Committee. We like to limit it to five minutes. This is a crucial issue. I am grateful for you being here. With that, Mr. Donahoe, you are recognized for an opening statement.

STATEMENT OF PATRICK DONAHOE, POSTMASTER GENERAL AND CEO, UNITED STATES POSTAL SERVICE

Mr. DONAHOE. Thank you, Mr. Chairman. Mr. Chairman and members of the Subcommittee, good morning. Thank you for scheduling this important hearing. I appreciate the opportunity to testify about the financial state of the Postal Service, about our five year plan to restore the Postal Service to profitability and long-term financial stability, and about our proposal to manage health care insurance for Postal employees and retirees.

America depends on a financially strong Postal Service. The Postal Service provides a vital national delivery platform that is part of the bedrock infrastructure of the American economy. It supports a $900 billion mailing industry that employs 7.5 million people. Every American residence and business depends on a regular, secure, and affordable delivery of mail and packages.

Nevertheless, due to a rise in electronic bill payment and the economic recession that began in 2008, the Postal Service has been in a financial crisis. In response to a 25 percent decline in the use of first class mail, the largest and most profitable part of our business, the Postal Service has aggressively cut costs and taken the responsible steps to return to profitability.

We have generated cost savings of $10.5 billion since 2008 and have reduced the size of the workforce by 106,000 employees, and done so without layoffs or disruption in service. Indeed, our service levels have never been higher.

Unfortunately, we cannot emerge from our financial crisis within the current legal framework. Absent a legislative remedy, the Postal Service will default this fiscal year on mandated prepayments to the Postal Service Retiree Health Benefit Fund. And as troubling as our current cash crisis is, these near-term shortfalls pale in comparison to our long-term financial challenges.

Mr. Chairman, the Postal Service has put forth a comprehensive five-year plan that provides a clear path towards financial stability. Our plan would enable the repayment of all existing debt and fully fund future health care obligations. Our plan will also position the Postal Service to better meet the changing mailing and shipping needs of the American public.

The plan we have developed is the result of an exhaustive process of evaluating every appropriate option to reduce costs and retain or grow revenue. We have worked with Evercore Partners, one of the Nation's leading restructuring firms, to validate our approach. At the core of the plan is a reduction in annual costs of $22.5 billion by the year 2016. Our plan calls for, and we are aggressively pursuing, the realignment of our mail processing, retail, and delivery operations. This realignment of the operational network is expected to yield more than $9 billion in annual cost reductions.

Among the major legislative reforms we are recommending, the most significant includes enabling the Postal Service to provide employee and retiree health benefits independent of the Federal programs. This has the potential to produce approximately $7 billion in annual cost reductions and eliminate the need for any further scheduled prefunding of retiree health benefits. If provided the authority to do so, we believe that we can provide our employees and retirees with the same or better health cover for significantly less cost. Both our employees and retirees and the Postal Service would end up paying lower premiums.

Mr. Chairman, without legislative reform that quickly enables meaningful operational changes in cost reductions, the Postal Service could incur annual losses as great as $21 billion by the year 2016. As a result, it is not inconceivable that the Postal Service may soon require appropriations greater than $20 billion a year. Fortunately, such an outcome is entirely avoidable. The Postal Service does not want to become a burden to the American taxpayer.

The Postal Service is currently recording a loss of $25 million a day. If our plan is fully implemented, we could record a profit of $6 million per day by 2016 and be debt free. We believe the plan we have proposed for the consideration of Congress is a strong one. Our plan would restore the Postal Service to profitability and financial stability; it would enable the Postal Service to meet its universal service obligations and continue to provide secure, reliable, and affordable service to the American public.

We believe it is a responsible approach that is fair to our customers and fair to our employees, as well as fair to the American public to which we serve.

I look forward to discussing this with you today and would be more than pleased to take any of your questions. Thank you very much.

[Prepared statement of Mr. Donahoe follows:]

UNITED STATES POSTAL SERVICE

STATEMENT OF
POSTMASTER GENERAL/CEO PATRICK R. DONAHOE
BEFORE THE
SUBCOMMITTEE ON FEDERAL WORKFORCE, U.S. POSTAL SERVICE & LABOR POLICY
UNITED STATES HOUSE OF REPRESENTATIVES

MARCH 27, 2012

Good morning, Mr. Chairman, and members of the Committee. Thank you for the invitation and thank you, Mr. Chairman, for calling this hearing to discuss recent Postal Service proposals to cut $22.5 billion in costs by 2016, and also provide details on the Postal Service's proposal to sponsor its own health care program.

My testimony provides a brief synopsis of the Postal Service's Plan to Profitability, also known as our Five-Year Business Plan, and contains a deeper discussion of the largest single component of that plan – reducing the Postal Service's health care costs by sponsoring our own health care plan. The Plan to Profitability, created by the Postal Service, has been subjected to rigorous independent review. Implementation of these strategies – and realization of the substantial savings they will produce – is integral to the future of the Postal Service. We are confident that the implementation of these proposals will sustain the Postal Service well into the future.

The Postal Service is at a crossroads. Our business model is broken. We have insufficient revenue to cover our costs and are rapidly approaching our statutory debt limit of $15 billion. If the Postal Service were a private company, we would be engaged in Chapter 11 bankruptcy proceedings. Our financial crisis is the result of a restrictive business model and a permanent and fundamental shift away from First-Class Mail. During the past five fiscal years, the Postal Service recorded cumulative losses of $25 billion. The requirement to prefund Retiree Health Benefits (RHB), mandated by the *Postal Accountability and Enhancement Act of 2006* (PAEA), drove $21 billion of the five year losses. It should be noted that development of a Postal Service-sponsored health care plan will eliminate the need to make the prefunding payments mandated by the PAEA. It is clear our current operating costs are unsustainable. *[Figure 1]*

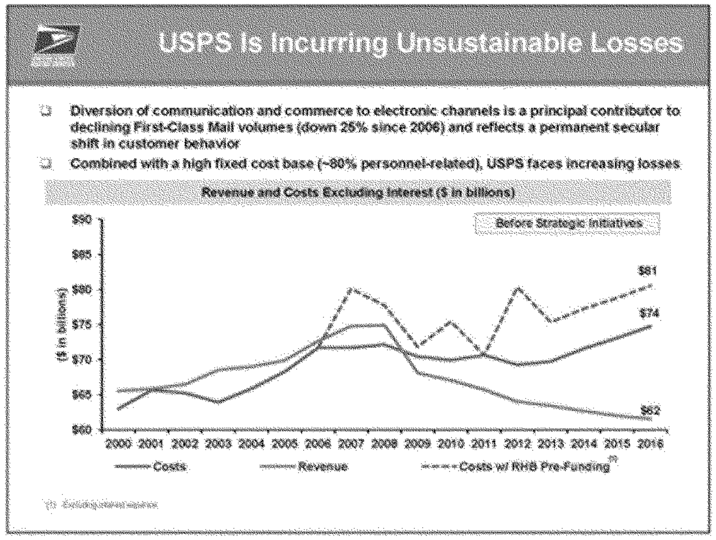

Figure 1

In the face of these continued unsustainable and crippling losses, the Postal Service developed our Five-Year Business Plan to enhance existing efforts and accelerate completion of a long-standing goal of bringing the Postal Service back to financial stability. Our plan is aggressive. We are taking steps within our control to implement the plan. However, there are limitations on what the Postal Service can accomplish on our own. Portions of the plan are outside the scope of the Postal Service's control and are achievable only through enactment of legislation. Congress will play a key role in helping the Postal Service close the widening gap between revenue and cost. The financial crisis facing the Postal Service demands both immediate and comprehensive reform. Absent any action at all, from Congress or the Postal Service, we could see deficits exceed $21 billion annually by 2016, with a net debt reaching over $92 billion by the end of 2016. *[Figure 2]* We do not have sufficient cash to pay $11.1 billion of RHB pre-funding due later this fiscal year. Doing nothing is not an option.

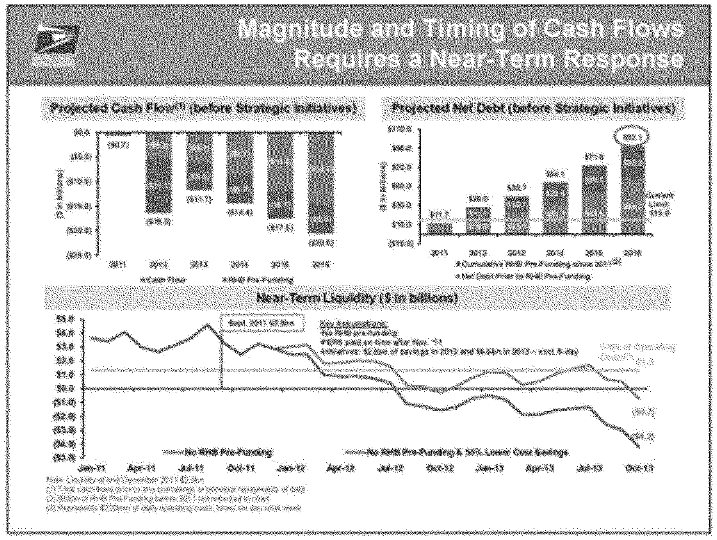

Figure 2

PLAN TO PROFITABILITY

For more than 230 years, the Postal Service has fulfilled our core mission to bind the nation together, currently delivering to every address across the country. The Postal Service continues to be the core component of a mailing industry that employs over 7 ½ million Americans, working for thousands of companies and businesses – all of which are deeply invested in the mail. The mailing industry makes up approximately 7 percent of the country's Gross Domestic Product (GDP). A review of the performance of postal service providers by the Oxford Strategic Consulting firm ranks the U.S. Postal Service the best postal service within the world's top 20 largest economies for access to services, resource efficiency and public trust. The study showed the Postal Service delivering 200 percent more efficiently than the next highest ranked post. The importance of a healthy and thriving Postal Service cannot be overstated.

As previously noted, there are multiple factors contributing to the current financial problems that the Postal Service is experiencing. First-Class Mail, the most profitable class of mail, continues to rapidly decline, largely due to electronic diversion. First-Class Mail volume has declined by 25 percent over the past five years, and Postal Service projections show that total mail volume will drop from 168 billion pieces in 2011 to 144 billion pieces by 2016. At the same time, other factors combine to exacerbate the Postal Service's financial situation. For example, prices on many products are capped at the rate of inflation. This limits the Postal Service's flexibility to adjust prices in response to market forces or offset temporary cost increases, such as the fuel surcharges commonly employed by our competitors to offset their rising costs. In addition, labor costs continue to rise. These costs account for 80 percent of the Postal Service's total costs, and 38% of personnel costs are tied to federal benefits programs outside of our control. The Postal Service operates on a fixed cost base that is driven by delivery points, retail locations, mail processing facilities, and six-day delivery. In the future, costs are projected to outpace revenue at an alarming rate.

The Five-Year Business Plan identifies various strategies by which the Postal Service can realize substantial savings by 2016. The plan is based upon several straightforward and simple key objectives. *[Figure 3]* It includes aggressive actions to reduce annual costs and deliver the changes needed to preserve our mission to provide secure, reliable, and affordable universal delivery service. The plan will advance economic growth, enhance commerce, and provide comprehensive transformation for a long-term sustainable financial future. It requires no appropriated dollars, and is fair to both employees and customers. Implementation of all components of the plan is essential to achieving financial stability. A piecemeal approach – enacting only portions of the plan – or a delay in adoption of all proposals will decrease the projected overall savings.

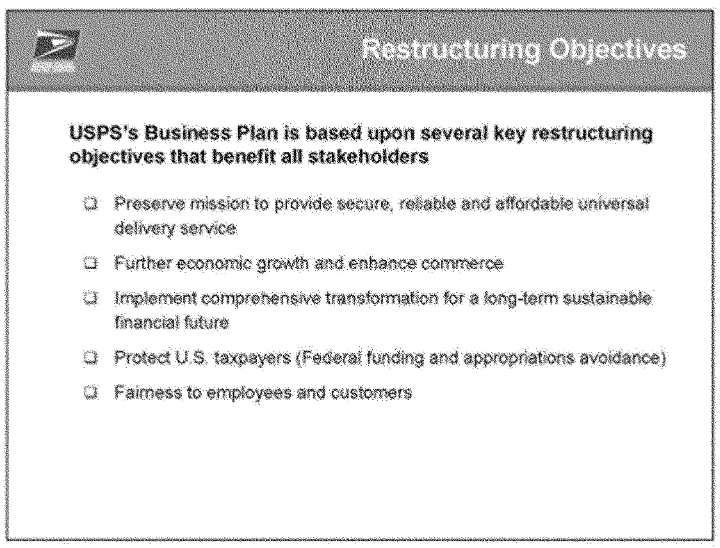

Figure 3

In developing our plan, the Postal Service identified areas over which we have control, areas which require legislation, and areas which call for a combination of solutions from both the Postal Service and Congress. Strategies include improving the efficiency of the network, delivery initiatives, increasing revenue generation and addressing total workforce costs to achieve annual savings of $22.5 billion by 2016. *[Figure 4]*

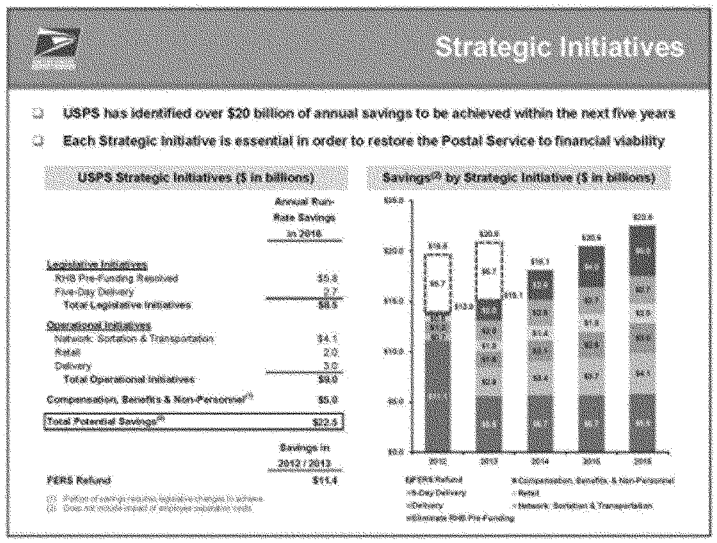

Figure 4

Postal Service network costs are fixed and – as the network exists now – are too high for today's reduced mail volumes. Any responsible employer would not continue to operate unneeded facilities or employ more workers than its business needs. The Postal Service needs the flexibility to realign its people and equipment to better match the precipitous decline in volume. Facilities must be re-evaluated and streamlined, and cost reductions must be realized for local Post Offices. The Postal Service is developing a number of alternatives to closing Post Offices that could sustain offices in rural communities at a reduced cost to the Postal Service. This is still in the discussion stage, but I will be happy to provide additional information as details are finalized.

The plan also addresses the need to reduce the size of our network, which could bring a total projected annual savings of $9 billion. These savings include $4.1 billion in mail processing and transportation costs, $2 billion in retail savings, and $3 billion in delivery operations. To enable the changes in the postal physical infrastructure, service standards (the number of days it takes for mail to be delivered from one ZIP Code to another) must be revised. Service standard changes will allow for an expanded operating window and thus more efficient use of existing equipment and mail processing capacity, and it will eliminate our need for many of our current under-utilized processing plants.

Revenue management is also a key component to the Plan to Profitability. We continue to implement innovative new products and services to generate new revenue. While we have considered and implemented a number of incremental revenue opportunities, the Postal Service is limited in its authority to provide non-postal services. And, research by external consultants shows that, even in European and other liberalized posts, it is not possible to achieve financial stability through revenue initiatives alone, without a fundamental change in the business model.

The Plan to Profitability also contains initiatives to reduce workload and staffing. In response to declining mail volumes and to increase productivity, the Postal Service consolidated over 200 mail processing facilities in the past five years from our peak number of 673 facilities in 2006. In doing so, we have customarily provided a "soft landing" for employees through retirements and reassigning staff, in an effort to minimize impacts on employees. *[Figure 5]* We have been, and continue to be, a responsible employer.

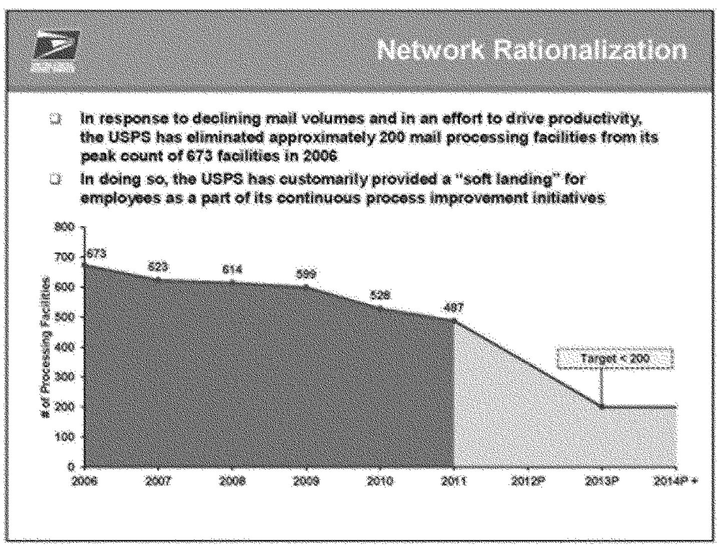

Figure 5

The Postal Service projects a further reduction of the equivalent of 155,000 full-time career employees by 2016, which we plan to achieve largely through attrition as half of our career employees are eligible for optional or early retirement. The Plan to Profitability focuses on workforce reductions through employee attrition versus layoffs or wage reductions, meaning impacted career employees would be able to retire or find another job in the Postal Service. *[Figure 6]*

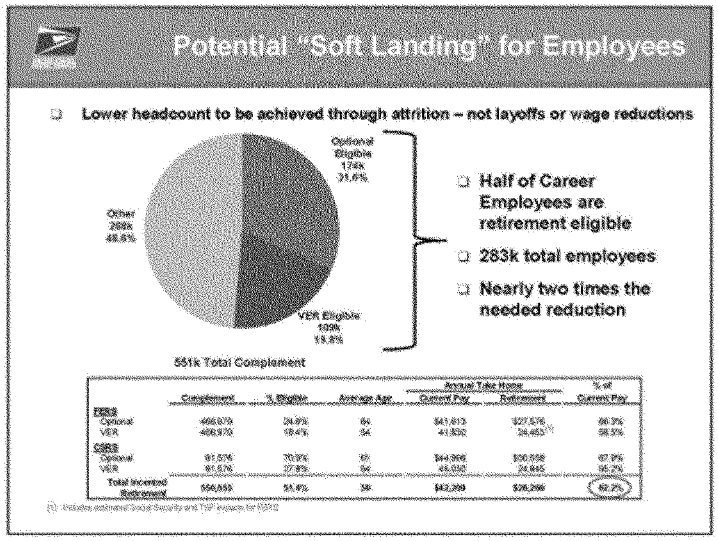

Figure 6

Portions of the Plan to Profitability require targeted legislative changes. These changes represent annual cost reductions that will return the Postal Service to profitability. Strategies that require enactment of legislation include the ability of the Postal Service plan to transition to a five-day per week delivery model. The change in delivery frequency could save the Postal Service $2.7 billion per year. Equally important is legislation directing the return of the overfunding of the Federal Employees' Retirement System (FERS). The Office of Personnel Management (OPM) has determined that the amount of overfunding stood at $10.9 billion as of September 2010, and OPM has projected that it increased by an additional $500 million during FY 2011. Although the refund would not be a recurring annual savings in the Plan to Profitability, a legislative change that would allow the return of the FERS overfunding would provide vital cash flow for our immediate financial needs, as well as help to pay down debt.

The Postal Service's Plan to Profitability consists of several thoughtful and effective strategies for achieving the goal of $22.5 billion in savings by 2016. There are three key items for consideration, which will yield tremendous savings and allow the Postal Service to also maintain its commitment to providing affordable and reliable service to the nation. *[Figure 7]* Significant savings will be realized from implementation of a Postal Service-sponsored health care system. The next section of this written testimony covers this in greater detail. Reducing the density of the Postal Service's physical infrastructure and network will bring additional savings and increase efficiencies. Post Office optimization efforts are continually evolving and the Postal Service is continuing to work toward solutions that will enable communities to retain retail access, under various scenarios. We continue to evaluate and consider multiple alternatives, which will be shared upon reaching a final decision.

The Postal Service wants to ensure our Plan to Profitability moves us in the right direction, using sound business principles and effective strategies. The plan has been thoroughly examined and analyzed by an independent advisor. Evercore Partners, Inc. is one of the nation's leading independent investment banking firms. They have served as financial advisors on several major corporate restructuring efforts. They played an important role in analyzing Postal Service models and assumptions and validating the approach taken by management in developing the plan. Their confidence in the strategies and their evaluation of the plan enhances the Postal Service's confidence that these proposals will return the Postal Service to profitability.

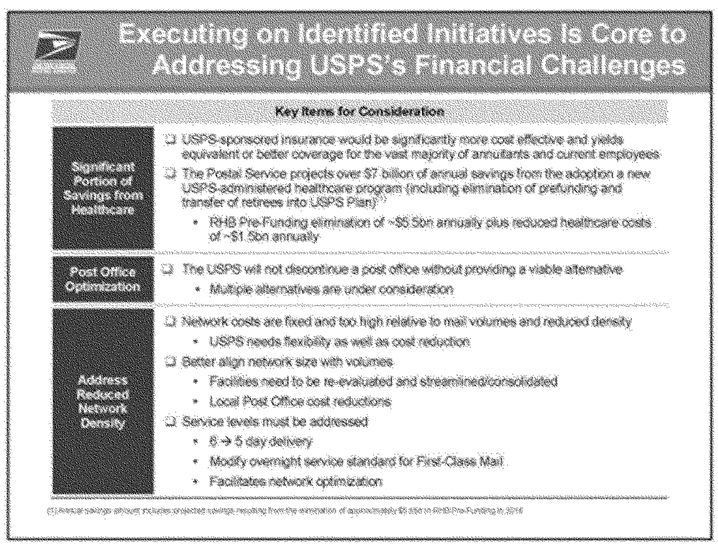

Figure 7

The Postal Service's Plan to Profitability was also evaluated in a national survey conducted by the respected market research firm, Opinion Research Corporation. The firm assessed consumers' preferences for postal action to resolve the Postal Service's serious financial crisis. By a wide margin, customers prefer the Postal Service to implement major changes (56%) outlined in its comprehensive five-year plan to profitability, including eliminating Saturday delivery, consolidating mail processing plants, and changing service standards, over raising prices (18%), receiving a Congressional appropriation (15%), or cutting employee salaries/benefits (11%).

The Plan to Profitability includes a Postal Service-sponsored health care program that is independent of other federal health insurance programs. Establishing a Postal Service-sponsored health care program represents the largest part of the Plan to Profitability's savings, accounting for over $7 billion of annual savings. The plan includes the elimination of the RHB prefunding obligation established in the PAEA, which will save the Postal Service $5.5 billion to $5.8 billion annually through 2016. The plan also proposes to transfer current retirees into the Postal Service health program. The Postal Service plan would be significantly more cost effective, would reduce health care costs by approximately $1.5 billion annually and yield equivalent or better coverage for the vast majority of retirees and current employees.

When developing our proposal for a standalone health care program, the Postal Service had several objectives:

1. We wanted to increase our financial stability by managing our health care costs and eliminating the RHB prepayment in its current form.
2. Improving our health care program was another key objective. We did not want to cut costs at the price of sacrificing plan quality.
3. Finally, we wanted to maintain a quality health care program to achieve savings not only for the Postal Service, but also for our employees, retirees, and their families.

The Postal Service, along with health insurance and actuarial experts at AON Consulting and the Hay Group, has conducted an exhaustive analysis of this health care proposal. We have shared our proposal with the Office of Personnel Management (OPM), and asked for a response from them in writing. We also briefed the Government Accountability Office (GAO), and the US Postal Service Office of Inspector General (USPS OIG). We look forward to sitting down with GAO to discuss the plan with them. The Postal Service is also conducting extensive discussions with all stakeholders, including unions, management associations, Congress, and the Administration.

I want to talk in a little more detail about key elements of the plan and how we can realize significant savings as a direct result of this proposal. As I mentioned earlier, this is the largest part of savings in the Plan to Profitability.

HEALTH CARE PROPOSAL

Unlike employers in the private sector, the Postal Service does not have the authority to actively manage its health care costs. We cannot introduce targeted wellness incentives and disease management programs for employees. We cannot leverage the significant purchasing power of our more than one million employees and retirees directly to negotiate a better deal in the competitive health insurance market. We cannot ensure that Medicare-eligible retirees fully participate in the Medicare benefits both employees and the Postal Service paid into. And we are not able to take advantage of the savings available to employers providing retiree health care benefits through coordination with the prescription drug benefits provided under Part D of Medicare.

The Postal Service pays annual health care costs of $13.2 billion, which includes premiums for employees and retirees and the RHB prefunding mandate. Of that total annual amount, $5.6 billion is RHB prefunding, $3.2 billion is premiums for retirees, and $4.4 billion is premiums for employees. To put it in simple terms, approximately 20 cents of every dollar of revenue we generate goes to health care expenses. Cost fluctuations in this large component of our total operating costs, second only to wages, are largely out of our hands. The Postal Service can effectively control only employee contribution rates.

The Postal Service is proposing to create its own health care plan independent of the Federal Employee Health Benefits (FEHB) program, which would include employees, as well as current and future retirees. We are asking for the ability to better manage our costs. Without this fundamental change to dramatically reduce health care spending, there is no assurance we can afford our health care commitments to Postal employees and retirees.

Our health care plan proposal provides savings in a variety of ways:

First, the program design requires Medicare eligible employees fully participate in Medicare benefits. Today, large numbers of our retirees do not take advantage of Medicare Parts A & B, which significantly increases costs to the Postal Service. If 100% of our current Medicare eligible retirees were enrolled in Medicare, the Postal Service $565 million in the first year. The Postal Service and its employees have paid over $28 billion in Medicare taxes since 1984, and we need the return on investment for that expense – one that every other employer providing health care coverage for retirees in this country expects.

Second, it reduces our unfunded RHB prefunding liability to a level we can manage. The Postal Service would continue to fund retiree health benefits under normal actuarial funding to ensure that the funding required to meet commitments for future retirees remains adequate. And we will be accounting for our liability using the same accounting method that is universally used–and indeed required–for all private sector employers who provide retiree health benefits. All retiree claims would be paid out of the existing RHB Fund, in the same way that employers pay pension checks out of the pension fund, not out of the corporate treasury.

Additionally, we would be able to take advantage of the savings available to employers providing retiree health care benefits through coordination with the prescription drug benefits provided under Part D of Medicare. Our proposal will permit the Postal Service to realize the benefits of recent developments in this marketplace, including the availability of Employer Group Waiver Plans (EGWP). These plans are currently available from all of the major pharmacy benefit management companies and most of the major health insurance companies, and they save about $1,300 a year for each Medicare participant. Under our plan, we will have an EGWP plan which will save $568 million in the first year, and our employees and retirees will share in those savings.

Finally, the Postal Service health care plan would provide a simplified plan structure which will also lead to savings for most employees and retirees. We anticipate offering a national plan with three options – high, middle, and value. The plan would also offer four tiers of coverage – self only, self & spouse, self & child(ren), and self & family. Our employees and retirees currently only have access to two coverage options – self and self & family. The additional two tiers of coverage, self & spouse and self & child(ren), would offer lower premiums than self & family coverage, and provide significant savings opportunities to a most of our employees and retirees. The national plans, solicited through a competitive bidding process, will be required to demonstrate that they can deliver quality and network coverage comparable to FEHB plans anywhere in the country and our territories. We also plan to offer HMOs where those plans provide high value and where large numbers of Postal employees and retirees are currently enrolled in those plans now.

For active employees, since the Postal Service's overall premiums will be less, employees will benefit from lower premiums and their contributions will go down. With a simpler, more understandable set of health plan options employees and retirees will know what they are paying for and the value they are getting for their money. The new plan offering would align value and cost for each option offered. More expensive plans should always provide more generous benefits. That does not happen now within FEHB.

Under the new plan, future retirees will continue to enjoy the same benefits and lower contributions that were available to them during their career with the Postal Service. The Postal Service's health plan will require that, upon becoming eligible, they enroll in available Medicare programs. By doing so, they and the Postal Service can get a full return on the Medicare taxes we have both paid. That is not happening today.

Current retirees will also see positive impacts. There will be no impact – other than lower premiums – on current retirees before they are eligible for Medicare. For current retirees who are eligible for Medicare, there are two groups: retirees who enroll in available Medicare plans and those who do not. For those who are already enrolled, they typically have 100 percent coverage of their health care expenses, divided between payments from Medicare and their FEHB plan. Virtually all those retirees will see their costs go down, through the lower premiums the new plan will produce. Those who are not enrolled in Medicare now must pay the deductibles and copays and other out-of-pocket expenses, depending on the particular FEHB plan in which they are enrolled. By ensuring that they enroll in Medicare just as future retirees will, current retirees who enroll will have the same 100 percent coverage as those enrolled now, and their lower contributions and higher benefits will generally offset, or more than offset, the premiums they will have to pay for Medicare Part B. This is especially true for retirees who have a dependent spouse also eligible for Medicare, since they will have much lower contributions under our new plan's four tier arrangement for dependents' coverage.

A Postal Service sponsored health care plan maintains our commitment to our dedicated workforce, especially given the fact that current health care costs are unsustainable. The plan would implement best practices unavailable today through FEHB, such as improved prescription drug coverage and wellness incentives. It will also leverage the purchasing power of more than one million Postal employees and retirees, in order to obtain better pricing in the competitive health insurance market.

In summary, under our health care plan proposal, the Postal Service will save almost $7 billion in the first year. Of that $7 billion, $1.1 billion is due to reduced premiums, and $5.5-$5.8 billion is due to eliminating the need for RHB prepayments. That figure represents about a third of the savings needed to achieve $22.5 billion in savings by 2016. Employees and retirees alike will share in the savings, realizing additional savings of some $650 million through reduced contributions and better benefits coverage. The contribution reductions alone represent about 85% of the savings for employees and retirees. But to realize the full benefit of these savings opportunities, Congress must act to allow the Postal Service to sponsor its own health care plan and to eliminate the RHB prefunding requirement. If Congress acts soon, we have the ability to enact this plan with an effective date as early as January 2013.

The Postal Service is encouraged by the significant savings laid out in our Plan to Profitability, which includes its health care proposal. However, there are suggestions that the Postal Service should be mainly focused on new revenue generation in order to close the gap between costs and revenue. Much work has been done – and continues to take place – on developing new sources of revenue and innovative products and services. Even with these efforts, the Postal Service will be unable to simply grow its way out of the current financial crisis. Still, we continue to pursue adoption of new revenue streams, including in the area of non-postal products.

LONG-TERM REVENUE PROJECTIONS

The Postal Service of tomorrow will consist of a varying mix of mail products, including First-Class Mail, Direct Mail, and packages. We see a bright future in many of our product and service offerings. We have had great success with several new offerings, including our 2nd Ounce Free pricing offering, which allows businesses to mail First-Class Mail automation, presort letters weighing up to 2 ounces at the 1 ounce postage rate. 2nd Ounce Free pricing provides customers with greater value in transaction mailings by letting them include an additional ounce in their mailpiece, which can be used for operational or marketing purposes at no additional cost. We are also excited about our Every Door Direct Mail product designed for small businesses. For less than 15 cents per piece, our customers can send fliers, menus, brochures and advertisements in highly targeted ways. Our Every Door Direct Mail Web tool enables restaurants, doctors' offices and other small businesses to map their coverage areas online, so they can zero in on the streets and neighborhoods they want to reach. The Postal Service expects to generate $1 billion in revenue this year from this easy-to-use product.

Our package business market share recently increased one percentage point for competitive products. Our Click-N-Ship service makes it simple for package customers pay for postage and print shipping labels for their packages right at their own computer. With more than a million registered users, half of whom are small businesses, Click-N-Ship has been remarkably successful. Our redesign of Click-N-Ship, which includes several improvements, such as simplified Priority Mail Flat Rate shipping and a simplified payment and printing process, will help us become even stronger in the shipping channel.

It is true that many international posts derive a larger percentage of revenue from non-mail products and services, such as banking and insurance. Research has confirmed that our retail units do not have the wage levels or foot traffic to profitably expand into such services. However, we are looking at new and emerging communications technology, like digital mail. Responding to customers' changing needs is key for us to continue our role of binding the nation together through communications and commerce.

MARKET RESEARCH

The Postal Service conducted market research related to potential service standard changes. A questionnaire used in the fall of 2011 asked business customer respondents about scenarios that would never be implemented simultaneously.

Specifically, the survey asked whether business customer respondents would lessen their use of the mail if the Postal Service immediately imposed service standard changes, altered delivery frequency, realigned our network of mail processing facilities and other actions. Any such contemplated actions, if implemented, would be done over a phased, five-year time horizon, providing adequate time for planning.

The survey failed to ask basic questions about whether businesses were planning to change their mailing behaviors in the absence of any such actions by the Postal Service. Upon review of the initial study results, the study's design was deemed to be seriously flawed. The research project was cancelled at that time and a new survey was conducted. The Postal Service clarified these issues as part of testimony delivered last week at the Postal Regulatory Commission.

CONCLUSION

The Plan to Profitability is based on key restructuring objectives that benefit all stakeholders. It preserves our mission to provide secure, reliable, and affordable universal delivery service, advances economic growth and enhances commerce, requires no appropriated dollars, is fair to both employees and customers, and provides comprehensive transformation for a long-term sustainable financial future. The Postal Service is currently losing $25 million per day, and is fast approaching our $15 billion debt limit. Implementation of all components of the Plan to Profitability will put us on a much more positive financial path – one where we will be earning $6 million per day by 2016, paying down our debt and functioning as a stable and profitable business. We cannot do it alone, however. Achieving successful implementation of all components requires a united effort. *[Figure 8]* I am confident the Plan to Profitability, will bring about the changes necessary to put the Postal Service back on solid financial ground.

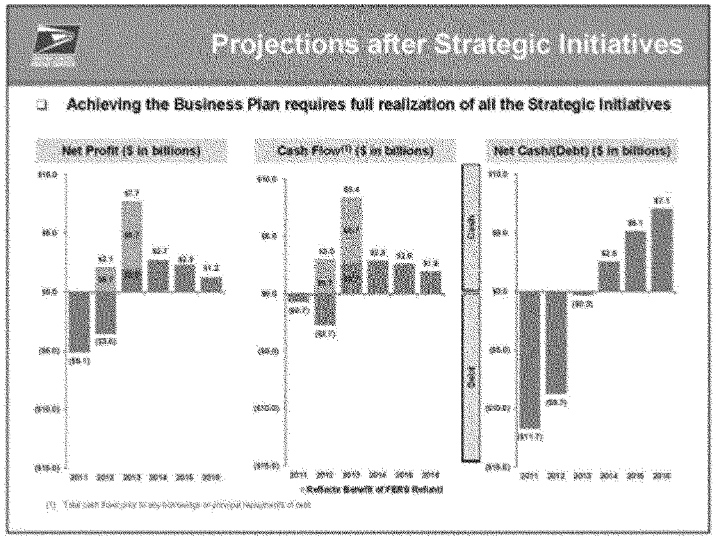

Figure 8

The Plan to Profitability represents a bold and decisive move forward in continuing to transform the Postal Service into a 21st century postal system. There is no disagreement that the Postal Service is currently at a critical juncture in its long history. Action is the key to bringing about needed changes to an outdated business model. This action must come from across all stakeholder lines. The Postal Service continues to do everything within our control to bring costs in line with revenues, return the Postal Service to financial stability and preserve the affordability of mail. Congress must also act to enable implementation of these strategies and goals. Employees, the mailing industry, union and management organizations and customers also play a part in the success of this plan. I look forward to working with each of you to keep the Postal Service an integral and dependable delivery service to all Americans for many years to come. Thank you.

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Mr. ROSS. Thank you, Mr. Postmaster.

With that, I will recognize myself for five minutes for questioning.

Mr. Donahoe, 150 million homes and businesses each day rely on the effectiveness and efficiency of the Postal Service to deliver their mail; 8.7 million employees are somehow or another, indirectly or directly, dependent upon the Postal Service for success. So today I think there are many that are hanging on your words as you give your testimony and answer the questions today.

To go straight to one of the points that I think is most glaring at us is the cost of doing business for the Postal Service, and we know that over 80 percent of that cost is labor. With your plan for profitability that includes sustaining your own health care benefits, what have been your efforts and your results in dealing with the APWU, the Letter Carriers, and others in trying to sell this particular package?

Mr. DONAHOE. Thank you, Mr. Chairman. First of all, let me just say that I agree wholeheartedly with your concerns about the entire postal industry. This is a major issue for us. Sending the right message to this industry in terms of people who use us to present bills and manage their cash flow, as well as advertising and shipping their packages, is extremely important, so the quicker we act and get ourselves back on firm financial footing, the better for the entire industry.

In regard to the unions, we have had a lot of, I think, very productive discussions, and we are still in the discussion phase with these proposals. The goal in the short-term has been to get to the point where everybody understands what the proposals are, to listen and make sure that, going forward, everybody is on the same page. We are not at the point where we are in agreement yet, but we are at the point where we are discussing and getting a good knowledge base on these issues.

Mr. ROSS. Let me ask you this. In getting to that point, is it a catalyst that your financial situation is such that you may run out of money soon?

Mr. DONAHOE. I think that the unions realize the financial situation that we are in.

Mr. ROSS. And when do you think is there a risk of the Postal Service running out of money this year?

Mr. DONAHOE. Here is where we are from a cash perspective. Our finances this year have been a little bit better than projected; we are about $600 million ahead of our finance plan right now. In October of this year we will be required to make a payment of $1.3 billion to the Department of Labor. At that point we will be at about $100 million in cash on hand. That is razor thin. Our operating cash for a day is $200 million a day. We will be able to go as long as the finances hold up this year, but in October 2013 we would be in a cash crisis.

Now, that also precludes us not making the prefunding payments this year.

Mr. ROSS. Okay, so right now it doesn't look likely that you are going to be able to make the prefunding payments for 2012.

Mr. DONAHOE. No. No, we are not.

Mr. ROSS. Which come due in November.

Mr. DONAHOE. Yes.

Mr. ROSS. And you are thinking, then, that if we stay on this course with inactivity of this Congress, then you are going to be out of cash to operate the United States Postal Service by October of 2013?

Mr. DONAHOE. We would be out of cash as it stands now. There are some options that we could take, that we have taken before, to conserve cash, like suspension of payment into the FERS fund that we are overfunded by $11 billion, but I would strongly encourage Congress to move now. This is much more of an issue of a crisis of confidence about the postal industry than it is just our cash flow. The faster we can resolve this and get focused moving forward on growing this industry——

Mr. ROSS. Quick question about the reduction in workforce. I laud you and the Postal Service over the last few years in trying to respond to the decline in revenues because of first class mail not being utilized as much. There has been a decrease in the number of employees in the United States Postal Service. I recognize that; I think that is tremendous. I also understand that we have probably close to 150,000 employees that, by way of attrition, will be necessary in order to right-size the expenditure side of the Postal Service.

Do you have any plans or suggestions for those that are currently eligible for retirement to incentivize retirement?

Mr. DONAHOE. We think that by the year 2015 we need to be at about 400,000 current employees. Presently there are about 155,000 people that can retire, with another 100,000 eligible over the course of the next five years. We do plan on issuing some incentives based on the fact that we make some changes in our operations. As we shrink the network, as we move to six to five day delivery, we would put some incentive money to move people along.

It is critical for us to move the headcount down, but at the same time we have a lot of non-career people on the rolls that are less expensive to work with, but they are also younger people, and if we had to take them off the workforce, they would end up unemployed, and I don't want to do that.

Mr. ROSS. One real quick question; I am running out of time. The impact on Medicare under your health care plan, could you expound on that?

Mr. DONAHOE. The way that we are looking at the entire plan, what we would like to be able to do is take full advantage of Medicare, just like any other organization. Right now the Postal Service is the second largest contributor into the Medicare system. We think it is only fair that our employees and our retirees get to take advantage of Medicare and enjoy the savings of a wraparound plan that is more affordable for them, just like any other private corporation.

Mr. ROSS. I appreciate that. My time is up.

I now recognize the Ranking Member from Massachusetts, Mr. Lynch, for an opening statement and then we will move right into questions for you.

Mr. LYNCH. Why don't we go right into the questions?

Thank you, Postmaster General. Good morning.

Mr. DONAHOE. Morning.

Mr. LYNCH. You are making me nervous. I am just trying to figure out and we have been dealing with FEHBP for a while now. There are some colossal inefficiencies in that whole system.

So I can see where the opportunities for savings within that plan exists, and I have fought for some of those plans, especially with the pharmaceutical side. I think we are losing about $1 billion a year, honestly, on the drug plans offered by the pharmacy benefit managers. We are not getting the value that we should be getting for the taxpayer or for the employee. We are being ripped off, I think. So I am pretty frustrated because we haven't been able to move. I have legislation to try to save that.

So, on one hand I do see some opportunities for savings, but how many members, we have 8 million in the wider system for Federal employees?

Mr. DONAHOE. I think it is around 9 million total.

Mr. LYNCH. Okay.

Mr. DONAHOE. Total employees, retirees, and their families.

Mr. LYNCH. Okay. So you have, admittedly, or at least in theory there is a certain amount of leverage that we have having 9 million participants in the Federal Employee Health Benefit Plan. Now you are suggesting we are going to extract about 600,000, if you add survivors and what-not, by extracting the Postal employees from that wider plan, and I am just concerned about the lack of leverage, the lack of our ability to capitalize on savings opportunities as a separate group.

I also know that the mail handlers' plan, which is very popular among Postal employees, I think my mom and dad are in that, two of my sisters, all 55 of my cousins. I am kidding. I am kidding. I am kidding. There are only about 17 of them.

[Laughter.]

Mr. LYNCH. But there is a lot of popularity in that plan and I am just nervous that you are going to make it unaffordable. People hate change.

Mr. DONAHOE. Sure.

Mr. LYNCH. Especially when they have something that works for them; it is stable, it is reliable, it is fairly efficient. So what happens to my folks that are in the mail handlers' plan? Now, if you were suggesting that we are going to give people another opportunity here and we are going to give them another plan, and there was an opt-in opportunity where, if you ran a good plan, you ran a low-cost plan, you ran an effective plan, people would opt into that by their own volition, because I think there are a lot of people that you could convince that you could do a better job. I think there are some people that are unhappy out there.

If that were the case, I would have less problem with it. However, what you are suggesting here, I think, is we are going to pull our people out and that there is not a whole lot of choice there for the employees who would like to stay with the plan they have now. Could you address some of that?

Mr. DONAHOE. Absolutely. I would be more than happy to.

The key thing from our perspective is to find the best plan for all of our employees and retirees, and what we have been doing over the course of the last year is working on that with consultant Ayon Corporation and Hay Corporation to put together an excellent plan. So the first thing I would assure you is whatever we would present to employees and retirees would be something they would be interested in.

The idea is not to run it ourselves, per se. What we would do is go out on the market and actually bid competitively for one of the large health providers like a Blue Cross or United Healthcare, one of those companies out there, to run the plan. What we would offer in the plan would be a number of different options.

Number one, you would have a couple of different tiers, a high value, a medium value, and a low value plan A young person, 25 years old, they may pick the low value. We would also give people options: single, single plus one, plus family, family. So that gives people some options there too.

What has happened with your mom and dad, if they are Medicare age, and I don't know if they are, they have actually already done what we are proposing to do. They have measured the value of the mail handler plan and said I will sign up for Medicare A and B, and I can save money taking this mail handler plan.

That is exactly what we propose. We would like to have a plan for the current employees and then a wraparound plan for the Medicare-eligible employees that gives them excellent value at a low cost, so they would use Medicare as their primary provider and have this backup plan from a wraparound. That saves a lot of money, because today what happens is a person like me or other people who would be retiring may never change their health care, and the Postal Service and the retirees end up paying full health care plan for the rest of their lives, when in fact they could get much better value at that lower cost.

So we have looked at this from a total top to bottom perspective and making sure that the good value is there for the employees and the retirees.

Mr. LYNCH. Well, I have enormous respect for you and I also understand how difficult the environment is right now. But as a lawmaker we need to drill down. I need to know every last detail about this if this is something that you are serious about, and I think you are. And we need to talk to the employees and let them know that this is what is being suggested, and we need to be poking at this thing and testing it, and whether or not this is really going to help the taxpayer and is going to help the Postal customer. Obviously this is really primarily going to impact Postal employees and their families. So we will keep talking.

Mr. DONAHOE. Thank you.

Mr. LYNCH. I am not convinced. I am not convinced.

Mr. DONAHOE. That is fine.

Mr. LYNCH. But we will keep talking. Part of it is I need to know more. But thank you, I appreciate your testimony today.

Mr. DONAHOE. Thank you.

Mr. ROSS. Thank you, Mr. Lynch.

I now recognize the Chairman of the full Committee, the gentleman from California, Mr. Issa, for a round of questioning.

Mr. ISSA. Thank you.

I want to thank you, Mr. Postmaster. The work you do I won't say it is thankless, but it is pretty close. And I know that your program is not being well received in some quarters, particularly, well, the real austerity is not being well received, but even the shift to using Medicare in a primary position is not being well received, and one of the not well received people could perhaps be me.

I am probably going to support your doing this, but let's have no illusions: you are just cost-shifting. There is no real cost savings to the American people. The money in fact will be paid out of one hand in order to save out of another hand. Now, if you didn't have a projected $22.5 billion loss in just three years from now if no change is made, we probably would say no thank you, but suck it up and keep it in the rate base.

I think the questions today that I have is even if we do this, where with inaction is the rest of the savings going to come from? If we do this, how much more do we have to do? You have given us a program that makes an assumption that you will be $60 billion in revenue in 2015, is that correct?

Mr. DONAHOE. That is correct.

Mr. ISSA. Do you really believe you will be at $60 billion without some change in the trajectory in 2015?

Mr. DONAHOE. And I think the exact number is about 61 and change by 2016. I think that based on the fact that a lot of our research has shown that is the direction that mail is going, predominantly driven by first class, as well as a CPI-based rate change, we think that we will be right in that vicinity. We have been talking to customers, as I had mentioned here before.

My biggest fear is not so much diversion, electronic diversion that is happening with bill payment; my biggest fear is the electronic diversion of bill presentment if we don't stabilize the finance of the Postal Service. We have to get our finances stabilized. I think then that will keep bill presenters, first class mail in the mail. That is the best way for them to still communicate with their customers.

Mr. ISSA. Well, because I am a member of Congress and have extensive reporting, I want you to know that I am doing my share. I do get electronic presention, is that the word.

Mr. DONAHOE. Presentation.

Mr. ISSA. Presentation. But I also get the paper copy so that I can absolutely be sure that I can do my reports properly. So I am doing my share to make sure that is happening.

Mr. DONAHOE. Thank you.

Mr. ISSA. But let's be honest, it will be a cold day in hell before I would voluntarily write a check and put it in the envelope again. My regular bills are all paid electronically, as probably, if not everyone on the dais now, in the near future will be. So again, it is a rosy scenario to be at $61 billion in revenue. If the continued decline in other forms, magazines and the like, if they continue to have more robust online services and less current, you are going to have challenges, aren't you?

Mr. DONAHOE. Well, here is what we are looking at towards the future. We think that the Postal Service has three major products that will grow, either stay steady or grow going into the future: first class commercial mail bill presentment; advertising we know can grow. Advertising through the mail is the most effective way you can do it. And the package business. We are growing package business right now at a very brisk rate. Our final model delivery is running 15 percent over last year, and that is over the year before.

Mr. ISSA. Let me follow up on that, because it is true that that is one of the areas, and when I speak to many of your partners, most notably FedEx and UPS, you are critical to them, you are teamed. You are teamed on the back end, you are teamed on the final mile.

Isn't the future of the Post Office an efficient, effective delivery system that often carries, in greater amounts, all of the above, meaning that you are the last mile in many, many, many cases, and that allows you to continue to be more efficient while it allows them to save money? Isn't that, to a great extent, where you are going to be?

Mr. DONAHOE. That is where we are going to be and that is where the Country is going with the growth in e-commerce.

Mr. ISSA. Now, today, in rural areas, you are the last mile for newspapers in many cases, aren't you?

Mr. DONAHOE. Yes. Yes.

Mr. ISSA. And those newspapers choose to deliver on Saturdays, and you are planning, for major cost savings, to no longer deliver on Saturdays, is that correct?

Mr. DONAHOE. That is correct.

Mr. ISSA. Do you find it odd that the vast majority of these newspapers do not want a rate increase, say they cannot tolerate a rate increase, but they want you to continue delivering on Saturday?

Mr. DONAHOE. Well, right now we are still working through trying to get all stakeholders on the same page, but I think we can work with the newspaper industry too, if they are interested on Saturday delivery. But to your point, we feel we have to reduce it at this point.

Mr. ISSA. You have a very bold proposal that you offer Saturday delivery, but that it be self-paying, in other words, to the extent that people still want a Saturday delivery, for example, pharmaceuticals, where, for a smaller premium than FedEx or UPS, you can in fact still roll out that delivery.

Does that system in some way translate to other areas? For example, is it possible to maintain, if you are given the flexibility to make it pay its own way, maintain, for example, those newspapers on Saturday in rural areas? You have rural letter carriers. Is there any way that is going to pencil out if you are given complete flexibility, as long as it pays for itself?

Mr. DONAHOE. What our proposal is for Saturday is to keep post offices open, post office boxes, run the network, and deliver packages with an extra fee. To your point, with the technology today, with intelligent mail bar codes, we could actually deliver mail if a customer asks, again, making sure that we would charge the amount that would cover. So if a person absolutely needed delivery on Saturday of their letter mail and newspapers, I am sure the flexibility is there for us to work that out.

Mr. ISSA. So as Senator Lieberman and others in the Senate are reaching cloture on their bill and we are preparing for a date on the floor, should we have a sensible manager's amendment that would include greater flexibility, or does the current bill give you the flexibility you need for a modernized Saturday delivery, in addition to what we all understand to be historic Saturday delivery ceasing?

Mr. DONAHOE. I think any language that gives the Postal Service more flexibility is good, because with all the financial issues that we are facing, we could certainly use that flexibility for the customers, and I think working with our unions we can get more flexibility in the workforce to make sure that we can deliver that mail.

Mr. ISSA. Well, thank you. I note an esteemed former chief staff member here behind you. He knows how that should be written. I also see Mr. Clay, Sr. He certainly knows how the Committee works. I won't name everybody, but we would look forward to that. Obviously, it is probably on our side of the Capitol that we are going to have to put additional language in. We would like to work on making sure that language is flexible enough for your proactive proposals, which I think are every bit as important as the cost-cutting.

Mr. DONAHOE. Yes.

Mr. ISSA. I thank the Chairman and yield back.

Mr. ROSS. Thank you.

I now recognize the Ranking Member of the full Committee, the gentleman from Maryland, Mr. Cummings, for five minutes.

Mr. CUMMINGS. Thank you very much, Mr. Chairman.

I want to go back a moment to some things Mr. Lynch was saying. When you are talking about, and I agree with everything he said and I agree with his skeptical comments, about this health care plan, when you think about something like health care, it is so very, very important and vital to people, particularly in today's world. Have you had a discussion with the unions about the proposed health care plan?

Mr. DONAHOE. Yes. We have been talking with the unions and the management associations for the better part of about three or four months. What we have been trying to do is go through a process so everyone understands what is being proposed. So we talked about the original how we would set it up, the Medicare requirements. We have actually mocked up some proposals based on taking a set of private industry plans, averaging them together and comparing some costs with what we have today, and we have discussed those.

Mr. CUMMINGS. So you are saying that they have had some input into your thinking and your planning there with regard to the program?

Mr. DONAHOE. We have had discussions, but we have not come to an agreement. To your point, this is probably the most critical issue that people worry about, their health care, so we don't want to push them. We want to try to work through so that we understand. We listen at the same time.

Mr. Lynch mentioned the question about the mail handlers. One of the things that we have said to the unions is if you want to still maintain your plan, because some of them have a number of people and the rest of the Federal Government, we are fine with that.

Mr. CUMMINGS. One of the reasons why I mentioned unions is because they have, in my estimation, bent over backwards and have been very understanding, trying to work things out. It is just incredible the lengths that they have gone to try to work things through and understanding that sacrifices have to be made, and I would hate to see you coming up with these kinds of plans without having some type of input, because you are going to have to come back to them at some point anyway, and I think it is better to have people onboard as you go along and they feel as if they have been a part of the process, as opposed to going and trying to shove something down their throats.

Mr. DONAHOE. I agree 100 percent. We want to make sure we work with the unions on this and also the communication of the employees, and just as much so the communication with retirees, because there is a lot of concern, there is a lot of fear of the unknown out there, and it is just as important for us to listen to what the recommendations are and build that into the plan.

Mr. CUMMINGS. Now, let me go back to revenue. Packages rose some 8 percent?

Mr. DONAHOE. Priority mail, yes.

Mr. CUMMINGS. Priority mail. And why is that? Why do you think that is? Because I think whenever we find a sweet spot we need to kind of zero in on that to try to figure out how we increase it. Go ahead.

Mr. DONAHOE. I agree 100 percent. Couple things on priority mail. Number one, priority mail is an excellent value. That is the flat rate box, if it fits, it ships.

Mr. CUMMINGS. Oh, yes, that commercial. I like that commercial.

Mr. DONAHOE. There you go. And returns the same thing. We have really priced these well so that you have small users, small business, home business, it is very easy for them and large businesses to use priority mail.

The other thing we have concentrated on this year is visibility, so good scanning the whole way through. Our people have done a tremendous job improving that, so I think that is where you are seeing a lot of value and that is where you are seeing growth.

The other area that we have seen tremendous growth is that last mile, parcel select, that our letter carriers and rural carriers deliver. That is growing at almost 15 percent a year. So we are very excited about packages and that is why we would like to get a resolution around some of these issues, so we can get back and focus on growing advertising and marketing mail, packages, stabilizing first class mail.

Mr. CUMMINGS. Now, you are familiar with the Senate bill, are you not?

Mr. DONAHOE. Yes.

Mr. CUMMINGS. And what are your feelings about it? Any concerns that you have? Because I think it is quite possible that may very well be the vehicle that we may end up sort of using to try to figure this out. That is my opinion, though.

Mr. DONAHOE. Sure.

Mr. CUMMINGS. Mine only.

Mr. DONAHOE. We think there are some very good points in the Senate bill. We have had a number of discussions with Senators Lieberman, Carper, Brown, and Collins. We think there are some very good points in there. There are some suggestions we have made. We have said to them the biggest concern is the length of time. If we can move up some of the proposals to match up more with our plan, we will get back to a profitable nature quickly and then be able to focus on growth.

Mr. CUMMINGS. One last question. There have been discussions and you have said that maybe you would not have to close as many as 250, 200 and some processing centers. Can you talk about that for a moment, please?

Mr. DONAHOE. Sure. One of the questions that has come back from the Senate has been, rather than moving to the full phase of the network consolidation, is there a halfway point to keep more overnight service for local businesses and customers, and we think that there is an opportunity. We have done some studies around there, and it would require us closing about half as many facilities as we propose.

In order to stay true to the finances, we have pitched the idea that we would like to raise the price of single piece first class eventually up to 50 cents. That is about a billion dollar tradeoff each way; provide service, keep more of the network up, but we would need the finances on the revenue side of the house to stay true to the numbers.

Mr. CUMMINGS. Thank you, Mr. Chairman.

Mr. ROSS. Thank you, Mr. Cummings.

I now recognize the Vice Chairman of the Subcommittee, the gentleman from Michigan, Mr. Amash, for five minutes.

Mr. AMASH. Thank you, Mr. Chairman, and thank you, Mr. Donahoe. It is good to see you again.

Mr. DONAHOE. Good to see you.

Mr. AMASH. I have a few questions. When was the last year the Postal Service had a profit?

Mr. DONAHOE. I think we had a profit in 2006, maybe 2007. I can't be 100 percent sure, one of those two years.

Mr. AMASH. How much money did the Postal Service lose in the first quarter of 2012?

Mr. DONAHOE. With our requirement to prefund, about $3.3 billion.

Mr. AMASH. And how much do you expect to lose for the entire fiscal year?

Mr. DONAHOE. Depending on how we finish the year, probably in the vicinity of about $14 billion. We are a little ahead of our revenues right now and people have done a great job holding costs. The prefunding for this year accounts for both this year and last, so that is 11 billion of those dollars.

Mr. AMASH. Now, last year Congress acted at the last second to give you some temporary relief from the prefunding. What does the lack of certainty of whether or not you will have to make your payment each year do for your plan for profitability in your overall business model?

Mr. DONAHOE. We have to get that resolved. That is what we are proposing right now in terms of the health care proposals in the overall plan. But I will tell you it is much larger than us. This is an industry issue. To give you an example, if you are worried about the Postal Service being able to deliver your bills and statements, and you are worried about your cash flow as a large company, you are going to start thinking about alternatives. The faster we get this resolved, the faster people don't have to worry about alternatives to the mail.

Mr. AMASH. That goes nicely with my next question. In November 2011, you addressed the National Press Club and, according to the transcript, you said, "You know that phrase speed kills? Well, the lack of speed will kill the Postal Service. There is a stark choice: a more flexible business model that allows us to control costs quickly or very large losses that will ultimately burden the taxpayer."

If immediate action is needed to return the Postal Service to solvency, why did it decide to self-impose a five-month moratorium on closures and consolidations of its facilities?

Mr. DONAHOE. We were approached by members of the Senate and they asked us, in order to keep some stability with the employees and the customers, if we would agree to wait to give them an opportunity to get legislation out and over to the House, and get the legislation through the House and up to the President for signature. I didn't think that was an unreasonable ask.

As we work through these processes to consolidate facilities, it is not going to happen all at once. The way we consolidate will be done in a very thoughtful and careful method so we don't disrupt service. We are looking for the bottom line cost reductions, and we will get those, but these consolidations will happen over the course of the next year.

Mr. AMASH. So you were supportive of the Senate's request, then?

Mr. DONAHOE. They asked me for that consolidation; I had no issue with that.

Mr. AMASH. Chairman Ross and Chairman Issa wrote a comprehensive Postal reform bill last year that was passed by this Subcommittee and the full Oversight Committee. It is full of cost-saving measures that will revitalize the Postal Service. What parts of H.R. 2309 does the Postal Service support?

Mr. DONAHOE. We support the FERS refund; we support the ability to move and consolidate the network; we support the ability to move to consolidate from six day to five day delivery. Practically everything in the bill we are in support.

Mr. AMASH. In your written testimony you mentioned establishing a Postal Service-sponsored health care program represents the largest part of the plan for profitability savings, accounting for over $7 billion of annual savings. Does the Postal Service have the resources to maintain its own health care plan?

Mr. DONAHOE. What we would do for a health care plan is what any other company does; you go out into the free market, you bid that, you find the best health care provider to act as pretty much an overall health administration firm, say a Blue Cross or United Healthcare.

We would also expect to use HMOs or other health care to fill the gaps, because there are gaps out there, and that is the way that we would manage it. We would go out through a regular competitive request for proposal, and once we are able to secure the health care, the provider would manage the plan for us.

Mr. AMASH. And how long do you think it would take to implement such a plan?

Mr. DONAHOE. We have had some discussions with health care companies to understand that, to actually test out our ideas and see if they are sound. We would have to go through a request for information, an RFI, to get more and then go out with an actual bid. We think that we would be able to have a health care plan ready by 2014.

Mr. AMASH. All right. Thank you, Mr. Donahoe.

Mr. DONAHOE. Thank you.

Mr. ROSS. Thank you, Mr. Amash.

I now recognize the gentlelady from the District of Columbia, Ms. Norton, for five minutes. Good morning.

Ms. NORTON. Good morning, and thank you very much, Mr. Chairman. This is an important hearing we are having.

First, Mr. Donahoe, I just want to congratulate you and your union for what you have done so far. Never in the history of the Federal Government has a Federal agency downsized, saved billions of dollars without a single layoff.

And I must say that that could never have been done if there were not a union at a table. All hell would have broken loose if any private corporation or if the Federal Government had tried to make these billions of dollars in savings singlehandedly as a management matter. I also note that the fact that the Postal Service is doing better seems to me to be a sign of recovery. You are a virtual barometer about the economy itself.

Now, if you look at the top line of what you are proposing, there is a part of it that is counterintuitive because of the notion adopted by every country in the world, that the larger the pool, the less the cost of health care. That is what is before the Supreme Court now. That is what every country in the world does, it creates the largest pool it can. Every country in the world creates a pool of the nation itself. That is what we are trying to do with the Affordable Health Care Act.

Moreover, I am sympathetic to the Postal Service in this respect: we ask you to do what we ask no Federal agency to do. It is mind-boggling that what we do, including providing services, and yet we want to treat you as a private corporation. We haven't made up our minds how to treat you.

So I look at what might motivate this new idea of yours and I want to ask you, candidly, if you would have felt compelled to put forward this proposal if the post retiree fund contribution the Postal Service must make today was eliminated or substantially reduced. If that were not the case, would you feel compelled to come forward here today?

Mr. DONAHOE. One of the things, to your point, that we have looked at over a number of years is to actually own our own insurance plan, and your point of the size of the pool is critical. The size of the pool for the Postal Service would be about one million participants, retirees plus the——

Ms. NORTON. Compared with how many in the FEHBP?

Mr. DONAHOE. Well, compared within the FEHBP it is a smaller pool, but if you took that and you went out into the private market and bid that, that would be the largest single health care group or pool out there. And that is the exact thought behind what we have been looking at.

My feeling is that, not that we have any arguments with the FEHBP, I am sure that everybody tries to do their best there, they run a pool of 200-plus different plans, and there is no real way to get out and compete to get the best price. And we have had companies come in to talk to us about how they are saving in health care costs and providing better benefits through making the health care companies go out and compete and provide better pharmaceutical plans, et cetera, and we look at that and say, jeez, with a million people we should be able to get some of those same benefits.

Ms. NORTON. So the post retiree contribution issue is not what motivates the proposal?

Mr. DONAHOE. That is one of them. We have looked at this beforehand. However, with the retiree health benefit requirement, having our own health insurance does give us the opportunity to reduce those costs and manage Medicare at the same time. So what we are doing is looking at a number of things.

There is a potential that, as we work through these changes, we won't be at the point where we are fully resolved with the health care, and we will have to continue to work with the unionson that which will be——

Ms. NORTON. Mr. Donahoe, the first thing that any member of Congress will think about when a new proposal of this kind comes forward, and you have mentioned stakeholders, is what the OMB, and you say this plan has been vetted, what the OMB, what the OPM, what your own inspector general have said precisely about this plan.

Mr. DONAHOE. Yes. We have asked them, to your point, please look at that, shoot holes. Are we missing anything? So we have asked the IG to audit it and they have, and they have told us it looks good. We have been to the OPM; I have been there with Mr. Barry on a couple of occasions and actually have sent a number of our people back to look at it to make sure that any issues that were not covered we thoroughly vetted.

I think to Mr. Lynch's point and Mr. Cummings' point, we need to continue with that. We need to continue to examine——

Ms. NORTON. And what about the OMB?

Mr. DONAHOE. We have talked to the OMB, but in terms of really digging in, probably not to the same level. We have had discussions——

Ms. NORTON. Do you have anything in writing from those three——

Mr. DONAHOE. I have from my IG, and I have asked Mr. Barry at the OPM to please provide back in writing what his thoughts are.

Ms. NORTON. Mr. Chairman, could I ask that what Mr. Donahoe has in writing from the OMB, the inspector general, and who else did you say?

Mr. DONAHOE. We have to get something back from the OMB. We have asked——

Ms. NORTON. The other two you have something in writing? Could you submit that to the Chairman so it can be——

Mr. ROSS. Without objection.

Mr. DONAHOE. Absolutely.

Ms. NORTON. Thank you very much, Mr. Chairman.

Mr. ROSS. Thank you.

We now recognize the gentleman from Illinois, Mr. Davis, for five minutes.

Mr. DAVIS. Thank you very much, Mr. Chairman.

Thank you, Mr. Donahoe. I want to go back a little bit to the number of mail processing plants that we might be arriving at in terms of closure. I think some rethinking has been done from what was initially indicated.

Mr. DONAHOE. Yes.

Mr. DAVIS. Where are we now in terms of that?

Mr. DONAHOE. The original proposal was to move from approximately 487 down to around 200. We came back after we did our studies and proposed that we would go from 487 down to about 232.

Mr. DAVIS. Could I ask that, in light of the potential job impact and the uncertainties in the minds of individuals who would be affected greatly in terms of where they might end up working or having the opportunity to work, do we expect to have that maybe close to finalization by the 15th of May? That is a date that we have been talking about some things happening.

Mr. DONAHOE. We have been working through that with our employees. One of the things that we have continued to do, even though we have held the date for closings until after May 15th, was to continue to work with customers and employees. So we would know by then which employees would be affected.

What we are trying to do is go person by person, that is how important this is, so we can sit down with an employee and have a discussion if they want to retire, if they want to take a different job, if they want to do something different in their career, because as we have reduced headcount in the organization, we have always been very conscious to try to do the right thing as a responsible employer.

Mr. DAVIS. Do we have any round numbers in terms of how much we are likely or would like to be able to save as a result of this process?

Mr. DONAHOE. We think that the network reductions as proposed right now would save us about $2.5 billion. We also have actually taken about $400 million in revenue off of there based on feedback we have gotten from our customers. So the net would be about $2.1 billion.

Mr. DAVIS. Then let me shift over a little bit back to the line of questioning from Representative Norton. Did I glean that we are very comfortable from the responses that we have gotten from the stakeholders who vetted the proposed system that the Postal Service would run itself, in terms of health benefits and——

Mr. DONAHOE. I think comfort would probably not be the right word. I think that our feeling is, with our work with our IG, we have asked them, as we have gone along, make sure we are doing this the right way. We don't want to put something out that is incorrect. So we have kept them abreast.

The OPM, we are waiting back for answers in writing from them. We have been working with them and asking them again, as we make these proposals, does it make sense? What we are saying, is this legal? Does this make sense from a health care perspective.

I think any time you get into a big change like this, there is no real comfort level, it is just trying to reassure and ask the questions to make sure we are doing this the right way.

Mr. DAVIS. Let me ask what are we getting back from the unions as we interact with them around this proposed change?

Mr. DONAHOE. I think that the unions, as we have worked to communicate and explain what we are thinking, there have been a number of questions come back. From some of the unions they have said, jeez, you know, we have our own health care plan; what would happen with that? And that is something that has to be resolved. Of course, some of the other concerns have been what happens in the long-run if there is any problem with the Postal Service from a financial perspective.

Our proposal also includes putting together a trustee group like representatives of the unions, as well as management, and a third party like the Treasury or the OPM, somebody else in there that could oversee and make sure that all decisions were proper decisions going forward. And this has come about through all the discussions and looking at how other people have gone through those processes. But to your point, we have to be very careful and make sure everybody knows exactly what is on the table and what is being proposed.

Mr. DAVIS. Have you looked at or explored or thought about a Postal only plan within the Federal Employees Health Benefits Program?

Mr. DONAHOE. We have talked to the OPM about that and that is something we have said to them if you could come back to us and say how, managed within there, we could get the same benefits, the same savings and flexibility, we would certainly be open to something like that.

Mr. DAVIS. So we still have a number of options open relative to how we close the loop on providing these benefits.

Mr. DONAHOE. Yes.

Mr. DAVIS. Thank you very much.

And thank you, Mr. Chairman.

Mr. ROSS. Thank you, Mr. Davis.

For those who want to hang around, I would like to do another round with you.

Specifically, I want to recognize myself for five minutes, but also ask you about rates. You have talked about increasing postal rates from 44 cents to 50 cents. My concern is even though I was a lawyer by trade, I had an undergraduate degree in business, and some of the business models we would deal with when I was in school would be that if nobody is buying your product, one of the last things you do is raise your rates. And my concern here is that the assumptions upon which you are basing your increase in revenues with an increase in rates, does that take into the cause and effect a declining user base of first class postage?

Mr. DONAHOE. This would be the way we would approach this: our prices are broken out right now competitive and market dominant.

Mr. ROSS. Right.

Mr. DONAHOE. For the most part, we would follow the pricing scheme that we have now with the CPI cap on all of our market-dominant products. The only portion of mail that we would look at to increase the price would be specifically the single piece, the blue mailbox mail that you or I might use to send a card or mail a bill in. That is a volume that has continued to shrink.

Mr. ROSS. Right.

Mr. DONAHOE. And as that has shrunk, that has generated the recommendations of shrinking our network down. Now, there have been some suggestions that have been made to slow the shrinking down to some extent over the course of the next couple years, not be as drastic, and our approach to that has been if that is an option, if that is the will of the Congress, if that is where people want to go, that we would propose to increase just that single piece stamp rate to make up the difference of the savings that we would lose.

Mr. ROSS. But wouldn't logic and reason and, quite frankly, laws of economics dictate, then, that you might actually have an even further decline in revenues because of a lack of buyers, if you will?

Mr. DONAHOE. That revenue is going, whether we like it or not, because of electronic diversion. It is kind of an interesting situation because the revenue of single piece is going away and we project it to continue to drop based on bill payment online and electronic diversion. But there are other portions of that mail that are very inelastic. So we have looked at——

Mr. ROSS. Inelastic. Even if you went from six to five days it would still be inelastic?

Mr. DONAHOE. Yes, because it is convenient. Even today with Forever stamps, you can buy a book of Forever stamps and pay 45 cents apiece and use those five years from now when the postage rate might be 50 cents. So it is a good deal for people.

Mr. ROSS. Real quickly on your charts there, because I want to go to the second part there, operational initiatives. It looks as though you have formulated a $9 billion savings with those three particular areas. Could you identify those? You are talking about the reduction there, I guess, in the network and sortation and transportation?

Mr. DONAHOE. Right.

Mr. ROSS. If you could go over each one of those three in the middle part there.

Mr. DONAHOE. Sure. Here?

Mr. ROSS. Right there, yes, sir.

Mr. DONAHOE. Okay. What we have laid out here are three basic approaches. We have legislative initiatives, that is the prefunding result in five day. That is worth about $8.5 billion. The network itself, that is the facilities, retail, post offices, and then our delivery routes. We think there is about $9 billion worth of savings there. And then the final is compensation and benefits. That is health care savings plus more flexibility with the union contracts.

Mr. ROSS. And specifically on the middle part there, when you say the savings in network, that is through consolidation, correct?

Mr. DONAHOE. That is consolidation of——

Mr. ROSS. How would that affect the geographic delivery of mail, if any, when those changes are made?

Mr. DONAHOE. What we are proposing is changing service standards today from one, two, and three days, to two and three days.

What that would allow us to do is to consolidate substantially into the smaller number of plants, going from 487 down to the 232 we proposed. What that allows you to do is to use those buildings for 20 hours a day, versus the 8 to 9 hours a day that we use now and save substantial amount of money; a lot of overhead, a lot of maintenance costs. That is the area that we would be able to get this——

Mr. ROSS. And the retail would be the consolidation or closure?

Mr. DONAHOE. The retail would be the consolidation and/or change in the cost of post offices.

Mr. ROSS. So you are talking about village post offices, that concept?

Mr. DONAHOE. We have four proposals right now that we think are very viable for post offices. One is to consolidate small ones into larger ones. And, again, we want to be very careful with the customers. That is only a mile or two. We are not proposing for people to have to drive 25 miles. Second is some type of a contract unit available at a local store that is open 7 days a week.

Another is to serve people off of the rural routes, and we have had people actually ask us, as we have had these 3700 community meetings, to move to rural delivery. But another solution is to match up the cost of the office with the revenue we bring in.

Mr. ROSS. Right.

Mr. DONAHOE. What we face right now is we have thousands of offices that cost us, on average, $70,000 to operate and bring in somewhere between $15,000 and $20,000. We think that there is a happy medium there. We are working with our postmaster associations. We will also go back to the community to work on this, too. Keep the flag flying, but we will be able to do it——

Mr. ROSS. And one last one—I am out of time—on the delivery. Are you going, then, from door to curb, is that——

Mr. DONAHOE. No, that does not include door to curb, that is improvements in what we call flat sequencing and also in the way that we have the route structured. That is something that we are working with the——

Mr. ROSS. So this doesn't include door to curb.

Mr. DONAHOE. No.

Mr. ROSS. And what is that estimated as annual savings?

Mr. DONAHOE. Door to curb varies. There are savings and there is also investment, and I would be more than happy to give you a paper on that. We have done a lot of research on that. That is also something, I will tell you, of all the research that we have done from a customer satisfaction standpoint, that is the one thing that customers don't want changed; they don't want their mailbox changed. So we did not include that in there.

Mr. ROSS. But isn't it true that only about 25 percent of Postal customers really get door-to-door anymore?

Mr. DONAHOE. It is about 30 million people.

Mr. ROSS. Okay.

Mr. DONAHOE. So we want to be sure we don't have 30 million people really mad at us.

Mr. ROSS. And I will follow up with you on that. Thank you very much. My time has expired.

Mr. DONAHOE. All right.

Mr. ROSS. I now recognize the Ranking Member, Mr. Lynch from Massachusetts, for five minutes.

Mr. LYNCH. Thank you, Mr. Chairman.

Postmaster General, in your proposal here, as Chairman Issa identified, there is a cost shift over to Medicare. How do you propose to do that in terms of just mechanically? Are you going to tell your Postal employees, okay, now it is mandatory? Are you going to ask Congress for the power to say to you that you can tell your Postal employees the first dollar has got to be from Medicare, you have to go to that first? Or are you going to have some type of option to have people go, or how is that going to work?

Mr. DONAHOE. We would prefer the mandatory requirement for Medicare. We are the second largest payer into Medicare, the Postal Service is, and we feel it balances the playing field with everybody else that uses Medicare. So we would ask to require Medicare A, B, and D, and that we would provide, as part of the health care proposal, a very good value, low-cost option to provide Medicare wraparound for B when our retirees sign up for that.

Mr. LYNCH. Okay, here is my problem. Right now on the Medicare side I am seeing a lot of docs refusing Medicare. So let's just say I have a Postal employee wants to go to that doc, now you it is mandatory that they go Medicare.

Mr. DONAHOE. Yes.

Mr. LYNCH. Their doc doesn't accept Medicare because reimbursement rates are pathetically low. So under your plan my person couldn't go to their doctor, right, they would have to go to some other doctor that accepts Medicare?

Mr. DONAHOE. I don't know the answer. That is something I would have to get back to you on. I am not sure how that works. With the wraparound, I don't know the answer to that on Medicare A and B, that if a person could actually choose to use that wraparound to cover some of that. I will have to get back to you on that.

Mr. LYNCH. Okay. Well, that is an important question because, ideally, I would like the opportunity, if you are going to require a person, in the first instance, to go Medicare, if their doctor, their existing doctor, current doctor does not accept Medicare, I would like there to be some other option. They have gone first, if it is rejected, then they can still go to the same doctor. There is this promise out there with the Affordable Care Act that everyone would still be able to go to their own doctor.

Mr. DONAHOE. Right.

Mr. LYNCH. That is not necessarily what is going on right now. And as this folds out over the coming years, I am concerned about even people being able to go to their own hospital.

Mr. DONAHOE. Yes.

Mr. LYNCH. Because I am seeing some hospitals are getting very shaky, so they may not be in existence. So I am concerned about that.

The number you have up there for five day delivery shows a savings of $2.7 billion.

Mr. DONAHOE. Yes.

Mr. LYNCH. We have had some analysis on this that shows it to be half of that.

Mr. DONAHOE. Yes.

Mr. LYNCH. Does this properly account for the fact, if you are not delivering on Saturday, and most people talk about the five day, eliminating Saturday, do you factor in the drop-off in volume? Because if I am mailing an important package on Thursday and I know it is not going to get there Friday because we have lower delivery standards, and it is not going to get there Saturday because the post office is closed, and it is not going to get there on Sunday because the post office is closed, and God forbid Monday is a holiday, there is going to be a drop-off in volume there. Have you factored that in fully because of the fact that you are not working Saturday?

Mr. DONAHOE. We did market research on that and I will tell you, off the top of my head, I can't remember the exact number, but I can give you that number. We have done some market research and that is why we picked Saturday, because it was by far the lowest volume day.

One of the proposals that we also have working through the Saturday delivery, to your point, is on non-widely observed holidays that fall now on Monday, we would deliver on Saturday. That is part of our proposal. So that closes that loop.

Mr. LYNCH. Okay, I only have about 30 seconds here, so let me just squeeze in this last one. I had an opportunity to meet with the folks from Pitney Bowes, and they are running a program in Denmark where they have a virtual mailbox now. So on your iPad or on your computer at home or on your laptop you can pull up a virtual mailbox, and what they do there is, as the mail comes into the processing center, it takes a picture of your mail. What you can do is you can click on the mail you want delivered and you can click off on the mail you don't want delivered. So it eliminates what some people call junk mail. We call it direct mail. I understand it. We call it jobs, right.

Now, that technology, are you looking at anything like that, where folks could use this virtual mailbox to click off on mail? Look, I have two girls at home; I get a ton of this stuff. They probably like to get it, but I sure don't. I am just thinking about looking down the road. Have we factored that in here? If they are doing it in Denmark now, number one, are we looking at that and have we factored that in? What is our plan?

Mr. DONAHOE. Well, I want to make sure your daughters get their mail, because then they will buy something and we will deliver it.

[Laughter.]

Mr. LYNCH. I bet you do. You are saving me money.

Mr. DONAHOE. We are. Right now we are looking at digital. In fact, we are in the process of establishing a group to take the lead on that, and we think there are big opportunities in the digital world from a digital transmission because we provide the safety and security of first class mail. We think that there are some opportunities to transition that into the digital world. But we also think that there are plenty of opportunities to grow revenue within the current products that we have now, employing some of those same technologies. So plenty to report out on that and we would like the opportunity to cover more of these digital areas.

The one thing that we will need from a legislative standpoint is just some clarity around the fact that we can get into those areas. That is part of the non-Postal we are looking for.

Mr. LYNCH. Okay. Just one yes or no question. I am abusing my time, I understand that, and I appreciate your patience with me. Have you been talking with Kevin Tally from the Rural Carriers and Jennifer Walburton from the National Association of Letter Carriers on this five day thing and where the numbers might be on this?

Mr. DONAHOE. I talked to Fred Rolando and to Jeanette. I don't know the other people.

Mr. LYNCH. Okay. All right, thank you.

Mr. DONAHOE. Thank you.

Mr. ROSS. Thank you, Mr. Lynch.

We now recognize the Ranking Member from the full Committee, Mr. Cummings from Maryland, for five minutes.

Mr. CUMMINGS. Mr. Donahoe, what went into the development of this plan? How did you come about it? You are dealing with some pretty exact numbers and projections, and I am just wondering, trying to get to the integrity of the plan.

Mr. DONAHOE. Sure. Here is how we approached this. To Mr. Darton's point earlier, facing the problems that we face with the retiree health benefit payment, rather than throwing our hands up and saying we can't do anything about it, we started to look at what actually made up the requirements of that retiree health benefit, and there were a number of things that came up. Number one was the requirements for health care for employees who weren't in the Medicare plan. There were some accounting issues and, of course, the cost of FEHBP plans that don't give you the value of the wraparound. So we have historically looked at having our own health care plan.

This goes back, I think we made some original studies right after the 2000–2001 time frame. So we went back and sat down with a couple of groups, Ayon Corporation and the Hay Group, two outside firms who are expert in this area, and we actually assembled a health care plan based on what we thought one would look like in the size and scope of an organization the size of the Postal Service. We designed it based on what other companies are doing today, looking for a number of value levels plus a number of different groups, the single payer, single plus one, family. The other thing we did was made sure that we had pharmaceutical coverage in that too.

So we sat down and pretty much built a health care proposal based off of all this information, and that is where we are right now. Taking that, then, and then comparing that to what we spend currently in FEHBP and the same way what we are doing in terms of Medicare today, and that is where we have arrived at the point where we are today. So we have done a lot of studies on this.

To the point we made before, we have talked to the OPM, the OMB, we have had our IG, we have had people come in from the outside, all the big health care providers, not on RFIs, but for discussion to understand how we can manage health care, how you can manage pharmaceuticals. A lot of work has been done.

Mr. CUMMINGS. And would the employee have to give up anything if going into your program?

Mr. DONAHOE. I can provide you all the detail. We have gone through and stratified every plan that every employee is in. I would say, for the most part, probably 95 percent of our employees would benefit from a better plan at a better cost. There are people who choose some very, very low value plans. They would probably have to pay a little bit more. But I can provide you all that data.

Mr. CUMMINGS. And I take it that when you have a plan where you have the four categories, I think it is four?

Mr. DONAHOE. Yes.

Mr. CUMMINGS. As opposed to two?

Mr. DONAHOE. Yes.

Mr. CUMMINGS. That allows for more precise measurement as to what it would cost the insurance company, is that right?

Mr. DONAHOE. Yes.

Mr. CUMMINGS. And therefore, hopefully, tailoring of the premium too.

Mr. DONAHOE. It gives you a better choice in terms of what you actually offer, and I will get you this information too, but I think that it actually ends up costing us a little bit more to give that actual flexibility. But I can provide you with that information. We think it is fair that a person shouldn't have to buy family if there is only two of them.

Mr. CUMMINGS. Sure.

Mr. DONAHOE. But I think that, as you shake all the numbers out, that is something that would fall back as more expensive for the Postal Service, but it is fair for the employees.

Mr. CUMMINGS. Now, someone asked you, I think it may have been the Chairman of the Subcommittee, asked you whether you were comfortable with the House bill, the one that we have developed so far, and you said just about everything.

Mr. DONAHOE. Yes.

Mr. CUMMINGS. Are you comfortable with the control board type system that is in there?

Mr. DONAHOE. That is the one area that I will tell you that I am not very comfortable with, and it is kind of a philosophical thing. I felt very strongly about the fact that, as a group of stakeholders, being the unions and the mailers, we should be able to figure out how to get these issues resolved working with Congress, working with the Administration, getting the right laws passed so that we don't have to go to a control board type of environment. What we have proposed in this plan, if we can get that through and everybody have a little bit of skin in the game, we can get the Postal Service back on good firm financial footing, clear that issue up with the mailers that were "going out of business," and really be strong for the next decades to come.

Mr. CUMMINGS. Thank you, Mr. Chairman.

Mr. ROSS. Thank you, Mr. Cummings.

We now recognize the Vice Chairman of the Subcommittee, the gentleman from Michigan, Mr. Amash, for five minutes.

Mr. AMASH. Thank you, Mr. Chairman, and thanks again, Mr. Donahoe.

In a March 2010 USPS action plan, USPS stated diversification to non-Postal activities, such as logistics, banking, and consumer goods, would not be viable due to high operating costs and relatively light customer traffic in post offices. Is this still your opinion?

Mr. DONAHOE. Yes.

Mr. AMASH. And could you elaborate on that?

Mr. DONAHOE. Here is the thing. The way we look at it is this. The Postal Service has a tremendously strong core business and we think that, looking out to the future, commercial first class mail, advertising mail, and packages provides us big opportunities to grow the business itself, as well make some additional money on new services. So our focus should be on being the best at what we do the best right now.

When you look at things like banking, there are banks on every corner. When you look at cell phones, AT&T is trying to merge with T Mobile because they can't make any money independently. Even if you study what the foreign posts do, if you look at what Germany does today, Germany makes their profits off of the mail. Of course, they charge 85 cents for a stamp to deliver the size of a territory like Ohio and Pennsylvania, but they don't make money on logistics. And it would be foolish for us, especially in a situation we are, to take our eye off the ball and get into something we are not good at.

Mr. AMASH. I have a slide up here which I think really emphasizes this point. This is from 2009. It shows a $7.8 billion shortfall. In order to make up that sort of shortfall, you need to run revenues of almost $150 billion. And to show you how big a deal that is, that would equate to creating 13 Fortune 500 companies, it would be more than twice the combined revenue of FedEx and UPS, it would be equal to capturing 5 percent market share of the total U.S. savings market, and it would be equivalent to building an e-commerce business eight times the size of Amazon.com. Do you have any comments on this?

Mr. DONAHOE. Well, I agree with that. It is better for the Postal Service to focus on the core mission. We have people that do an excellent job every day out there. We have the best network in the world, the house-to-house, business-to-business network. And with the growth in e-commerce that we can see coming up, we think there are definitely opportunities for us to grow that business.

Mr. AMASH. Thank you. I have a few questions about the health care plan.

Mr. DONAHOE. Sure.

Mr. AMASH. Currently, the taxpayer provides a backstop for Postal employees retiree health care benefits. Would you expect the backstop to continue if USPS leaves FEHBP?

Mr. DONAHOE. Backstop meaning that if we left FEHBP and the Postal Service was out of business, that there would be no——

Mr. AMASH. If you were running the plan yourself.

Mr. DONAHOE. Right. Here is the way we look at it. First of all, by implementing a plan like we are projecting now, we do not plan on going out of business. We plan on getting stronger and being strong out into the future. That is the goal right there.

Secondly, by working through how we actually set up the health care plan and how we manage the retirees and how we manage the prefunding money that is already in there, $45 billion, we think that will be enough to cover retiree health care benefits going out to the future. The key critical thing for us, though, is, again, a good, viable, financially strong Postal Service going out into the future.

Mr. AMASH. And would the premiums and benefits of a USPS-run health care plan be subject to collective bargaining?

Mr. DONAHOE. They could be. We have not really spent a lot of time on that, but it would be an area that would be open for collective bargaining. That is pretty much the way that the rest of American business does it today. Currently, the legislative issues cover retiree benefits and the retirement portion of the FEHBP. I think many years ago there was actually some collective bargaining done around benefits and, of course, we consider that going out to the future.

Mr. AMASH. And how would USPS prefer to have its separate health plan funded?

Mr. DONAHOE. We would fund it just like we do now. It is part of the business of running the organization. There is no government money coming our way. We want to be self-sufficient, like I said in my opening statement, and that is exactly how we would fund this.

Mr. AMASH. And would you immediately want to draw on the current Retiree Health Benefits Fund managed by OPM?

Mr. DONAHOE. There are a couple different options on that. We would have to sit down and walk through those with you. I think that as you go out there will be a need to start to use those funds, probably three or four years from now, but I don't know that we would be doing anything in the next couple years. But I would like to sit down with you. We have some people that know that stuff a lot better than me. I would be more than happy to cover that.

Mr. AMASH. Thanks for your time. I yield back.

Mr. DONAHOE. Thank you.

Mr. ROSS. Thank you, Mr. Amash.

We now recognize the gentlelady from the District of Columbia, Ms. Norton, for five minutes.

Ms. NORTON. Thank you, Mr. Chairman.

I have two questions I want to get in in my five minutes.

Mr. Donahoe, are you aware of the experience of agencies that have done exactly what you propose to do, like the FDIC have tried to do their own health care plan, only to come right back a couple years later?

Mr. DONAHOE. I am familiar with it. I understand that some of those changes were due to accounting changes the FDIC decided they——

Ms. NORTON. What do you mean by that?

Mr. DONAHOE. The prefunding requirements. From what I understand, when the FDIC moved off to have their own health care plan, once they were faced with law changes that required prefunding, they chose to move back with the FEHBP.

Ms. NORTON. Because the Federal Government required prefunding in their plan.

Mr. DONAHOE. Yes. And it was smarter for them to move back in.

Ms. NORTON. They didn't have prefunding before.

Mr. DONAHOE. I know.

Ms. NORTON. Because they were a Federal agency and these Federal agencies don't have to prefund, which, of course, goes back to my original question to you, would you be here if you did not have that requirement. And, Mr. Donahoe, I am not quite sure you would. There is every private employer who moves first to insurance because we are the only country where employers pay for insurance and that, of course, is the biggest part of what they have to take care of, even with the tax issue for them, which you don't even have.

Mr. DONAHOE. Yes.

Ms. NORTON. Let me ask you a question. I think the record would benefit from knowing how you are proceeding on the closings. We had a number of closings here, then some of them were taken off apparently by the Postal Service. How do you decide what post offices will be closed? I recognize they have been suspended after the Senate intervened, but I assume they are going to resume.

Mr. DONAHOE. Here is the way we would approach that. Post offices and stations and branches in, say, a city like Washington, we think there are a number of options. Number one, consolidation, which we are doing in some cases. Where we just don't have the foot traffic in a place, we would consolidate one into the other, maintain the zip code so customers would have no ill effects of changing an address.

In the rural areas we are looking to do some contracting with local stores that are open 24/7. In many cases our contract with them keeps the lights on in a place like that, and it is also convenient for customers. One of the other considerations in rural areas is what is called extension of rural delivery so that we deliver to a person's house, rather than having them to come to the post office.

But I think the key thing going forward, and this is something we have been working with our Postmaster Associations on, and that is being able to provide a better match up of costs and revenues for small post offices going forward. Maybe instead of opening for eight hours a day, we would be open for six hours a day. That matches the revenues up with the costs and it allows us to keep the lights on, the flag up there for customers to have access to the Postal Service.

Ms. NORTON. Shorter hours?

Mr. DONAHOE. In some cases, yes.

Ms. NORTON. Well, actually, your notion of partnering with a commercial establishment was part of an amendment I introduced. I couldn't imagine why this wouldn't have passed; it would help the private sector, it would help the Postal Service. But, believe it or not, that amendment did not pass, and it shows we are not looking always for win-wins.

But I have to tell you, in my own district, I got some information back that intrigued me that said that at a post office that was due to be shut, perhaps because of your other troubles, there was only one Postal clerk there. This was a neighborhood which people regard as very busy, very much in need of postal service. People would walk in and they would see these humongous lines with only one little person there, and they would just walk out again. So that is why I need to know what are your criteria when your own downsizing may have been inadvertently chasing people away from the Postal Service.

Mr. DONAHOE. That is a concern. One of the things that we pride ourselves on is customer service, and long lines is something we want to avoid. Years ago, when I worked in Washington, D.C., that was one of my major impetus, was to work better with customers, make sure that we provide a great service. Offline you can tell me what office that was, and I will make sure that we take care of that. But one of the things we are looking at is making sure that not only we have access to post offices, we are looking at putting more self-service in so the people have the opportunity to either go to the line or——

Ms. NORTON. How much are you going to save if you were to close every post office that is on your list? And I recognize that there is an appeal process. So if you are going to have savings, that appeal process is going to continue operative, isn't it? And if so, what would be the savings in the end, assuming that you prevailed in every appeal?

Mr. DONAHOE. We think that as we balance up the hours and the revenues, we will probably save about half a billion dollars, and that is keeping the majority of places open, it is just trying to make sure that we have the right number of resources there with the revenue that comes in the door.

Ms. NORTON. Thank you, Mr. Chairman.

Mr. ROSS. Thank you.

We now recognize the gentleman from Illinois, Mr. Davis, for five minutes.

Mr. DAVIS. Thank you very much, Mr. Chairman.

Mr. Donahoe, as we experience this era of declining mail volume, do you think that the current cap is reflective of your actual cost, or should maybe the PRC look at possibly reconfiguring the cap?

Mr. DONAHOE. Well, the cap, there is a good side and a bad side for the cap. The cap, from a Postal Service perspective, puts some discipline into the costs of the system and makes us work hard to stay efficient, which is a good thing. From a customer perspective, it provides a lot of predictability, which is a very good thing and helps us keep people in the mail.

To the discussion that we had earlier, we think that there is some ability for the Postal Service to raise single piece mail prices over the course of the next couple of years. Right now, by law, single piece and commercial mail is linked. We would like, by law, that to be changed and have some flexibility. The fact that we have Forever stamps out there, customers can buy them and use them forever, that gives them a little bit of a discount that way. But it would certainly help us generate a little bit of money with what we think even 45 cents is a pretty good bargain.

Mr. DAVIS. In his last round of questioning, Chairman Ross raised the issue of rates. Let me ask what do you see or what do you think might be in store for nonprofit or not-for-profit mailers under the proposals that we are looking at?

Mr. DONAHOE. The nonprofit revenues continue, from a standpoint of volume, continue to be strong in the organization. We have not come out, from a Postal Service perspective, and asked to change that. I know there has been some discussion about increasing the not-for-profit rates. Those people depend on the mail. They will tell you that even though they advertise a lot online, I don't think they get many donations online. The majority of the donations that come in to the not-for-profit come through the mail, and the good thing about those, a lot of those donations are mailed back with a 45 cent stamp, which is good for us.

Mr. DAVIS. I have no further questions. Thank you very much, Mr. Chairman.

Mr. ROSS. Thank you, Mr. Davis.

Mr. Donahoe, I appreciate your being here today. I am looking forward to continuing to work with my colleagues on both sides of the aisle and with you in making sure we do what is necessary to preserve this age-old institution, and make sure it is run efficiently and effectively. Thank you for time. That will conclude this first panel.

Mr. DONAHOE. Thank you.

Mr. ROSS. We will now take a few minutes and get ready for our second panel, Mr. Francis.

[Pause.]

Mr. ROSS. I will now reconvene the Subcommittee on Federal Workforce, U.S. Postal Service and Labor Policy, and welcome our next panel, our witness, Mr. Walton Francis, who is an author and a health care expert.

Mr. Francis, it is customary for those who testify before the Oversight Committee and its subcommittees that they be sworn in under oath, so if you wouldn't mind stand and raise your right hand.

Do you solemnly swear or affirm that the testimony you are about to give this Committee will be the truth, the whole truth, and nothing but the truth?

[Witness responds in the affirmative.]

Mr. ROSS. Thank you.

Let the record reflect that the witness answered in the affirmative.

Please be seated. We do have your opening statement by way of a written testimony before us, but please, I would like now to recognize you for five minutes for an opening statement.

STATEMENT OF WALTON FRANCIS, AUTHOR AND FEDERAL HEALTH CARE EXPERT

Mr. FRANCIS. Thank you, Mr. Chairman, members of the Committee. I am going to just try to summarize very briefly.

First, the proposal before you is essentially a proposal to dismantle the Federal Employees Health Benefits Program. That program covers 8 million people. Probably half the plans in that program will be forced out effectively. All the people in all those plans will be forced to move to new plans. A lot of these people are elderly, don't want any change. They are going to be faced with massive change. And all that proposal is unnecessary, which I will explain in a second. So that is the issue before you.

Let me just say, first, I happen to agree strongly with virtually the entire Postal plan that I heard described by the Postmaster General, and I cannot urge on you too strongly that it is incumbent on the Congress to fix the flawed legislation which the Postal Service now works and give it a chance to solve its problems. This part of it, however, isn't part of the solution, it is part of the problem.

Second general point, the FEHBP model, multiple plans competing for consumer business, is a widely adopted and copied model, and has been the winning model in the Congress of the United States and with the last two or three administrations for very good reasons, and I won't go through the whole list. The Breaux-Thomas proposal was to copy the FEHBP for Medicare. The Medicare Advantage program and the Part D programs, when enacted, were explicitly modeled after the FEHBP, with improvements, Okay? But that was the model. And both have been hugely successful.

The original Paul Ryan proposal, Ryan-Rivlin, Rivlin-Domeneci, Ryan-Wyden, which I think is maybe the best of that group. Just the budget resolution that the House passed a few days ago, the Medicare part of that is modeled on the FEHBP.

The Obama Administration's health reform, whichever side of that issue you are on, the State exchanges where multiple plans compete for people is modeled on the FEHBP.

Now let's talk about the prefunding issue. There is a reality here. The prefunding is not going to be paid, ever. The $5.4 billion is toast. It may be carried on the books as a debt owed the U.S. Government; it may be written away by legislation you pass. I don't know how it is going to be solved. The only thing I am sure of is it is not going to be paid.

So now the question is why are we going to destroy the FEHBP to create what amounts to a fig leaf for not paying the $5.4 billion? I just find that Kafkaesque. It is driven in part by the budget rules that control you to some degree in how you account for things, but that is the reality. And a part of that reality is the money in the trust fund, okay, actually, every trust fund, Social Security trust fund, but the prefunding retirement thing, that trust fund is a paper fiction, it is an accounting exercise. Any money spent out of that fund will actually be spent by taxing the American public or borrowing money to be paid by our children some years hence through taxes. The money is taxed, it is not there. Remember the Clinton Administration, all the lockbox talk about Social Security? That was essentially a debate over this same issue.

I will stop there, but merits of the proposal. I have to tell you I have read one of the consultant reports that the Postal Service got and I have read several of their own reports. They are full of errors, false assumptions, misstatements, and so on. I won't go through all the examples, but I have one simple one. They are talking about saving money on prescription drugs because they are going to operate a single plan that is going to enroll 2 million people. Well, the FEHBP has a single plan that enrolls 5 million people, it is called Blue Cross. Funny thing. How are they going to save more money covering 2 million people than we can save covering 5 million people? It is unreal, okay? It is made up.

They have never recognized, but I have given you in my testimony details, on it is going to cost at least half a billion dollars because the Postal employees are subsidized by the GS and other non-Postal employees who are much younger, on average, and healthier, and it is all one pool. So there is a half billion dollar-plus subsidy every year going into the Postal Service. Okay, they pull out, they are going to have to spend an extra half billion just to maintain existing benefits and premiums. They start a half billion a year behind.

The other point I want to emphasize is a lot of what is going on here is shifting costs from FEHBP to Medicare. That is not real savings, that is moving it from one pot to another. And when you get some real analysis from CBO or others, and I don't count the Postal Service Inspector General in this group, you are going to hear what I am telling you.

The Postal Service, unlike most Federal agencies, has a lot of flexibility right now under current law. One of the suggestions I made in my testimony, kind of buried near the end, is they could offer to pay its employees a bonus for signing up for Part B. Just say we will pay you $100 if you sign up. Or they could say we will pay you $100 if you switch from higher cost plans to lower cost plans. They have the ability to create employee incentives right now. They are not bound by the general pay schedule and all the rest.

Their record, I won't go through their record in the past. They have bargained with the unions quite improperly. The unions have sought the best possible benefits for their members. That is their job. But one of the prices paid by that has been overpaying premiums relative to the non-Postal side and relative to the private sector.

The good news in all this is they are focused like a laser on the biggest single defect in the FEHBP, the interface with Medicare. And I cannot commend to you too much how important it is to address that issue, but not for the Postal Service alone, for the entire program. It is crazy the way it is done now. And it is going to get worse. People are going to bail out more and more from Medicare.

I might add, this Committee, I don't think, has the jurisdiction to solve this problem alone. For one reason, they are proposing mandatory enrollment in Medicare Parts A and B. Well, I am going to tell you something. There are tens of thousands of 80-year-old widows, Postal Service widows who do not have coverage for Medicare Part A due to their work or their husband's work, and who opted out of Part B. The premium cost for one of those widows to join Parts A and B, right now under current law in the Social Security Act, is over $8,000 a year. That is what it would cause to mandate that that widow leave the Postal plan she is now in and sign up for A and B.

There are several ways to reform this. Part of the question will be who is how the saving is going to be shared between the Medicare program, the employing agencies, and the FEHBP system, and the retirees themselves. A lot of options here, but the basic idea, I think, is to provide positive incentives to retirees to join, first place, Medicare Part A is automatic. It is illegal to collect Social Security in this Country if you are not in Medicare Part A at age 65.

So this stuff about people aren't signing up for Part A or all these taxes that have been paid, all the taxes paid are Part A taxes. Anyone who is not in the 80s or 90s of Postal Service retirees already is in Part A once they hit 65. So that is a false issue and it has been misdescribed. Again, I am sure it not the Postmaster General's fault, but the people who write his speeches, the people who prepare these consulting documents aren't getting it right.

Part B, where the premium for most is $1200 a year, the right model is the employer or the plan, directly or through the employer, subsidize people, incentivize them to join Part B, and you don't have to give them 100 percent, complete wraparound benefits, which is what they now get if they have Part B, because that induces massive waste. And there are real savings to be made by reducing overutilization of medical care.

Thank you very much.

[Prepared statement of Mr. Francis follows:]

CAN A USPS-RUN HEALTH PLAN HELP SOLVE ITS FINANCIAL CRISIS?

Testimony of Walton Francis

Independent Consultant and Principal Author of
CHECKBOOK's Guide To Health Plans For Federal Employees

Before the Subcommittee on Federal Workforce, Postal Service, and Labor Policy

Committee on Oversight and Government Reform

U.S. House of Representatives

March 27, 2012

Mr. Chairman, and members of the Subcommittee:

I am pleased to testify before you today concerning the current status and performance of the Federal Employees Health Benefits Program (FEHBP) as it relates to the United States Postal Service (USPS) and USPS solvency problems. I am testifying in my personal capacity, not as the principal author of *CHECKBOOK's Guide to Health Plans for Federal Employees*, and not as a consultant to the Centers for Medicare and Medicaid Services. All views expressed are my own.

Let me start by saying that I have a great deal of sympathy for the USPS, which finds itself in a predicament that is primarily the result of a (1) flawed statute that enables the Congress of the United States to micromanage what should be business decisions, of (2) bizarre accounting and budget scoring rules that fail to recognize fiscal realties, (3) of an Internet business threat whose severity few if any could have fully foreseen as recently as a decade ago, and of (4) essential reforms to the Medicare/FEHBP interface that are long overdue and that were never seriously considered by the Congress over the last decade, under the stewardship of either party or either branch of government. For these reasons alone, the Congress should give the USPS fiscal relief to the tune of billions of dollars a year.

But the problem is also one of fiscal and bargaining mistakes by the USPS, and nowhere have these mistakes been as important as in its (5) decisions on health insurance subsidies for its employees. The USPS has for decades provided unnecessary subsidies to its employees' health insurance costs and, despite some recent reductions, still pays a higher share of premiums by far than is standard among American corporations or consistent with its fiscal condition.

I will address each of these issues in turn, and then address (6) the health insurance reforms that I think the USPS and the Congress should make. In fact, I regard the current postal fiscal crisis as a wonderful opportunity to make changes that would protect and preserve the FEHBP for decades to come, to the benefit of all employees and retirees, both postal and non-postal.

Dismantling the FEHBP

The USPS proposals would massively disrupt or destroy the FEHBP, the single most successful health insurance program ever operated by the United States government. In destroying the FEHBP, the USPS would disrupt the health insurance of 8 million Americans, and breach statutory entitlement promises made to millions of Federal retirees. In a world where the House of Representatives' own Budget Resolution, voted just a few days ago, is routinely dismissed as "radical" or "ideological," these proposals certainly exceed in immediate harm anything the Congress has previously endorsed or voted for other Medicare recipients or retirees. No one, for example, has previously proposed radical reductions in the statutory retirement benefits of existing Medicare retirees. Yet the USPS proposal does just that.

It would pull out almost one fourth of current Federal employee enrollees, and a like percentage of Federal annuitant enrollees. Plans that currently enroll half or more postal employees, such as the National Association of Letter Carriers (NALC) plan, and the Rural Postmaster plan, would be decimated. It is hard to see how the FEHBP could survive with any similarity to its current design. For example, there are 18 plan options available nationally to Federal employees and retirees. Of these plans, 15 are open to all employees. If all of the postal union plans (all but one of which are open to all Federal employees) went under, the total number of national plans would drop to 11, and those open to all would drop to 8. HMOs aside, plan choices would be cut in half for almost all employees and retirees. And many HMOs would leave the program as well, as their enrollment dropped in cities and towns all over America.

The numbers of employees and retirees affected would be staggering. For example, the Mail Handlers Standard option plan enrolls about 150,000 employees and retirees. Only about 10,000 of these are postal employees. If this plan went under, all 150,000 Federal employees and retirees would be forced to change plans. Likewise, the NALC plan enrolls about 120,000 employees and retirees. About 30,000 of these are postal employees. If this plan went under about 120,000 employees and retirees would be forced to change plans. In both cases all postal annuitants over the age of 65 would be forced not only to change plans but also to leave the FEHBP.

President Obama has been criticized for promising that under Health Reform all Americans would be able to stay in their existing health plans. To whatever degree this promise was exaggerated, the USPS plan, if adopted by the Congress, would make it look like solid gold.

The FEHBP as a Model for Insurance Reform

In my scholarly book, *Putting Medicare Consumers in Charge: Lessons from the FEHBP*, I concluded that over the last 50 years the FEHBP has outperformed Medicare in cost control, in service, in benefit generosity, in fraud prevention, and in protecting enrollees from catastrophically high health care expenses.

I was not the first to reach these conclusions. Every major Medicare reform proposal of the last decade, enacted or not, has been based on the FEHBP model. In 1995 the Heritage Foundation published "The FEHBP as a Model for Medicare Reform." During the Clinton Administration the National Bipartisan Commission on the Future of Medicare, otherwise known as the "Breaux/Thomas Commission," in 1999 endorsed the FEHBP model of consumer choice among competing plans by a majority vote, just short of a super-majority vote. During the recent Bush Administration the Republican-controlled Congress enacted the Medicare Modernization Act in 2003, explicitly modeling both the Medicare Advantage program and the Medicare Prescription Drug Program (Part D) on the FEHBP. In fact, the MMA requires that in administering these programs the Centers for Medicare and Medicaid Services (CMS) use the policies and methods of the FEHBP.

All of the recent reform proposals for Medicare, including the first Ryan plan, the Ryan/Rivlin plan, the Rivlin/Domeneci plan, the Burr/Coburn plan, the Lieberman/Coburn plan, and the Ryan/Wyden plan (among others), have attempted to follow even more closely the FEHBP model under which all plans (including original Medicare plans) compete on an equal footing to attract enrollees, holding down costs through competition among plans.

The Rand/Graham/Lee/Demint plan introduced last week, which would enroll all Medicare beneficiaries in the FEHBP, would not only follow the FEHBP model, but would explicitly rely on the FEHBP plans to enroll 50 million Medicare beneficiaries in the same risk pool as Federal employees and retirees. Whatever one's view of this scheme, the USPS proposal would destroy it as an option.

In the present charged political environment, with arguments before the Supreme Court on the individual mandate even today, I hesitate to mention this, but the Obama Administration's health reform law follows the model of the FEHBP in promoting competition among health plans in a health insurance exchange. And what, one might ask, are the major differences between the FEHBP statute and the legal challenge before the Supreme Court? One answer is that unlike health reform, the FEHBP does not impose an individual mandate.

It hardly seems inappropriate to ask how, of all those insurance experts of both parties and both houses of Congress who have looked to the FEHBP as a model, only the USPS sees it as an albatross to be abolished.

Follow the Money

The USPS has no professional or historical competence in insurance design or in analysis of health insurance reform models, and probably no real desire to gain these. The USPS is clearly looking for a solution that would allow it to obtain a taxpayer subsidy in the billions of dollars. It would do so by claiming that its new plan would enable it to eliminate or vastly reduce the contributions to FEHBP reserves for retirees that it is forced to make under present law. The motives for this are perfectly clear and transparent. Indeed, in some sense the logic of the USPS proposal is impeccable. If a debt is onerous, make whatever changes are needed to write it off.

It is not my intention to analyze the actuarial or legal rationale through which the USPS seeks to reduce, most notably, the $5 billion a year it is currently required to pay to "pre-fund" its retiree health benefits. But I will make the following observations, which can readily be confirmed by the Congressional Budget Office or any fiscal expert.

Under current law, the Federal government maintains a number of trust funds, including the Federal retiree health benefits trust fund, the Medicare Part A trust fund, and the Social Security trust fund, that are intended to somehow segregate and preserve funds to meet future obligations. Under the fiction that the USPS is a true business (a principal supposedly established in the 1970 Postal Reorganization Act, and reaffirmed in the 2006 Postal Accountability and Enhancement Act), the USPS is supposed to prefund its retiree obligations on the same basis as private corporations. But the 2006 Act in particular was an exercise in science fiction. It gave the Federal government a budget windfall in the arcane "scoring" rules that govern Congressional score keeping on budget matters.

But all these trust funds are "let's pretend." You may recall the debates late in the Clinton Administration over placing the Social Security trust fund in a "lock box." The only thing more surreal than those debates was the underlying reality: all of these trust funds are EMPTY in fact if not in accounting. The money has been spent. The only things remaining are accounting pretenses. Put another way, every dollar that the USPS does not contribute to deficit reduction through charges to its patrons or reductions in employee benefits is a dollar that the taxpayers will have to borrow now and repay in the future. The issue before the Congress is not whether or how to fund real obligations with monies placed in real trust funds, but how to apportion USPS insolvency among future taxpayers, postal patrons, and postal employees.

In February, the HayGroup consulting firm presented a purportedly sound analysis of the USPS proposals whose "starting point" was the measurement of trust fund obligations prepared by the OPM Office of the Actuary. But all estimates by that Office are based on the accounting fiction that the trust funds actually exist as dedicated funds unavailable to fund the government's current account deficit. The HayGroup report on "United States Postal Service Retiree Health Benefits" made clear in its key assumption on "Funding Method" that "the funding forecast assumes the

USPS retains the PSRHBF assets" (page 2). These assets do not exist except as a legal and accounting fiction. The money has been spent.

(As an aside, the HayGroup report was dated February 10, 2012, and assumes that all annuitants over age 65 "enroll in Medicare Parts A and B with no penalty" (page 4). Meanwhile, a USPS PowerPoint presentation entitle "USPS Health Care Program," apparently also prepared in February of 2012, says that "growing nonparticipation in Medicare increases costs for USPS and for participants" (page 3). Apparently the USPS and its consulting firm are not on the same page.)

This fiscal legerdemain then raises the obvious question: why dismantle the FEHBP to preserve accounting fictions that no responsible and informed adult believes to be true? Why not just eliminate the prepayment obligations by the stroke of a pen, and leave this valuable program to continue to provide high value for money? Is the Federal government really so incompetent that it would abolish one of its most cost-effective programs to maintain the pretense that it is fiscally responsible?

The USPS Substantive Proposals on the Merits

The USPS has changed its proposals in recent months. Originally, for example, it claimed that a major part of its savings would arise from paying new Postal employees a lower health insurance subsidy. This claim suffered from the obvious problem that the USPS won't be hiring any consequential number of new employees for decades as it downsizes—savings zero.

Then and now the USPS claims that FEHBP plan designs are somehow obsolete and do not match "best practices" in the private sector or align "cost to value." This naturally raises the question as to how all those Congressional leaders and experts of both parties could have been so badly fooled all these years. How is it that only the USPS has been able to detect that the FEHBP plans fail to provide health promotion and wellness benefits, and chronic condition and disease management programs? And of course the truth is that the FEHBP provides all these things and many more. It is more than passingly ironic that a USPS system facing ever more devastating competition, include parcel carriers and the Internet, fails to understand that competition among competing health plans drives down costs while improving service.

Nonetheless, the FEHBP is no longer the best model of effective competition among health plans. Medicare Advantage and Medicare Part D share that blue ribbon prize. After all, Part D has held its costs to a level roughly forty percent below that predicted by both CMS and CBO actuaries and experts, a record the FEHBP cannot match. But the FEHBP is no slouch, and has outperformed the "one size fits all" traditional Medicare for almost the entire history of both programs in controlling costs. As a point of comparison, the mis-designed TRICARE system makes even traditional Medicare look like a miracle of modern management.

The current "discussion draft" USPS proposal proudly proclaims that it will provide a reform that will "especially benefit annuitants who cover only self and spouse" (as opposed to larger families). The truth of this claim is easily tested. According to the U.S. government's Medical Expenditure Panel Survey (MEPS), the annual cost of health care at age 55 to 65 is about $8,000 per person. So the cost of health care for a retired couple is approximately $16,000. The annual cost for an adult under age 35 is about $2,000, and for a child is about $1,500, according to MEPS. So the annual cost of a premium for a retired couple would be about $16,000 (less cost-sharing) and for a young family of four about $7,000 (less cost sharing). In other words, this wonderful reform would, other things equal, charge retired couples more than double the premium amount charged young families.

The falsity of this pipe dream about the alleged benefits of a "couples" premium has been described for decades by the OPM actuaries and by advice given through *CHECKBOOK's Guide to Health Plans for Federal Employees*. But the postal bureaucrats who designed these "reforms" are not health insurance experts and would not be expected to know such things.

Interestingly, the February 2012 USPS discussion draft, in describing the "key features" of the "proposed USPS plan" demonstrates an either unintended or deliberate decision to drastically reduce insurance benefits. This contradicts previous USPS promises that it would maintain or improve those benefits.

Under the discussion draft proposal, Blue Cross Standard option is described as charging 15 percent in network coinsurance for most services. This is false. This plan charges no coinsurance for inpatient hospital services and $20 or $30 copays for most outpatient services. The document then goes on say that the Blue Cross plan has a $5,000 out of pocket limit and no limit for prescription drugs, even though drugs are included in the plan's $5,000 OOP limit. These features are proudly contrasted with a USPS "High Option" that charges 10 percent coinsurance for all hospital stays and all physician visits, and that has an OOP limit of $7,500 for medical and drug expenses combined. If the best USPS plan is so inferior to Blue Cross Standard option, one hesitates to describe the "Middle" and "Value" USPS options. Suffice it to say that not one single FEHBP plan has benefits as poor as the "Value Option," and only one has benefits as poor as the "middle" USPS option. So the truth is revealed: in sharp contrast to earlier promises, the USPS now proposes a massive reduction in health insurance benefits to current employees in the name of modernization and value purchasing.

To its seeming credit, the USPS plan includes a consumer-driven high deductible option in its so-called "Value Option." This plan would have a $4,000 deductible. But there is something missing. Unlike all the consumer-driven plans in the FEHBP, there is no Health Savings Account or comparable reimbursable arrangement. In the FEHBP plans, this account is typically about $1,500 to $2,000 for a family. In the USPS scheme, it got left on the cutting table.

It is not an easy task to design a sensible health insurance reform, and there is an important and essentially insurmountable problem facing the USPS proposal. The FEHBP operates as a single risk pool. An agency with a disproportionate number of older and more costly enrollees has its premium costs subsidized by agencies with a disproportionate number of younger and less costly enrollees. Younger and older enrollees pay the same premiums. Experts and ethicists differ on the merits of such a system. But whatever its overall merits, it is the reality of the FEHBP and of the system the USPS proposes to leave. What do current data tell us about the problems created by a pullout? Quite a lot! The following table shows the consequences to the USPS of a pullout from the FEHBP, using 2009 data:

Age:	Under 35	35-44	45-54	55-64	Over 65	Total
Ave Cost at that age (MEPS)	$2,000	$4,000	$6,000	$8,000	$11,000	
Number of postal self-only enrollments	15,000	25,000	69,000	62,000	7,000	178,000
Total Cost (M)	$30,000	$100,000	$414,000	$496,000	$77,000	$1,117,000
Average cost per postal employee						$6,275
Number of non-postal self-only enrollments	161,000	109,000	191,000	179,000	25,000	665,000
Total Cost ($M)	$322,000	$436,000	$1,146,000	$1,432,000	$275,000	$3,611,000
Average cost per non-postal employee						$5,430

As these numbers show, the USPS has an employee pool that is substantially more costly than that of non-postal employees, simply because it is older. To provide the identical benefits and premium levels to USPS employees that nonpostal employees receive will cost about one sixth more per employee, or about one tenth of the all-employee average. Put another way, just to break even the USPS will have to reduce benefits or increase premiums by about one tenth. Considering that USPS employees number about 500,000, and that average premium costs per enrollee in the program (self-only averaged with self and family) are about $11,000, the costs of a pullout to the USPS will exceed one billion dollars annually just to maintain current levels of benefits and premiums. And over time, as the postal work forced ages further, the costs will rise sharply.

Put another way, the FEHBP is a giant insurance pool. All workers and retirees pay either a self-only or self and family premium, regardless of their age. Younger workers subsidize older workers. Retirees with Medicare subsidize all the rest, because Medicare is "primary" and pays about three fourths of health care costs (more, for the few Federal retirees who get prescription drug coverage from Medicare). Within this pool, postal employees benefit because they are older and more costly than average. Were the USPS to pull out, its premiums would increase to maintain equivalent benefits, while those of other GS and other non-postal workers would decrease.

The USPS Record in Health Insurance Cost Control

Unlike almost all other agencies, the USPS has substantial discretion over insurance benefits. While the USPS was not given the authority to override OPM in plan participation and benefit design decisions, it was given the authority to decide on premium subsidy levels.

That authority, exercised through collective bargaining, has led to multi-billion dollar spending decisions. This year the USPS pays up to 83.5 percent of plan premiums, whereas for GS and other non-postal employees the maximum payment is 75 percent of plan premiums. And the USPS pays this rate up to 80 percent of the costs of the average plan, compared to a ceiling of 72 percent for nonpostal employees and all retirees. The result of this generous contribution formula is that on average the USPS pays about $1,000 more for family premiums, and about $500 more for self-only premiums, than the rest of the government. This is a rate negotiated through collective bargaining, and in prior years the difference was even larger, but for an organization that is essentially insolvent, and has known for years that insolvency loomed, that seems rather oddly generous. Considering that about two thirds of postal workers have family policies, the net cost of this differential in 2012 exceeds $400 million. Over the last five years, the cost of this differential has been close to $3 billion.

Incidentally, according to the Kaiser Family Foundation data on employer insurance, the average percentage of premium paid by large employers is around 70 percent. So it is the USPS, not the nonpostal work force, which is out of line with modern employer practice.

What is worse, the USPS initiated what is arguably the single worst mistake in the history of the FEHBP. "Premium conversion" is a system in which the employee share of premiums is tax-sheltered (this is on top of the tax-free status of the employer share). It is routinely used by corporate America because it shifts costs to Federal taxpayers. However, it makes no sense for the Federal government itself, because it takes from one pocket to put into the other. From an insurance design standpoint, in a competitive system like the FEHBP premium conversion is a disaster, because it attenuates the already weak incentives for enrollees to choose more frugal plans. Assuming that the marginal tax rate of a postal worker is about one third on average (this includes OASDI taxes and State income tax), the 16.5 percent employee share of premium becomes more like 10 percent.

Unfortunately, the Office of Personnel Management copied this mistake several years after the USPS led the way. It is hard to estimate with any precision the effects of this policy over the years, but it is likely that it has led to average premium increases, compared to what they would otherwise have been, of close to half a percent a year, or even more. Total FEHBP costs are likely several billion dollars a year higher than they would have been without premium conversion. There is dramatic confirmation of the relatively weak current incentives in today's

FEHBP in the failure of the several consumer-driven and high deductible plans—almost all of which are excellent buys—to attract more than about one percent of total FEHBP enrollment.

What the USPS Could Do Under Current Law

As the discussion above suggests, the FEHBP could generate much larger savings than it does now. Several years ago I developed a table to show Federal agencies how much they could save if they make *CHECKBOOK's Guide to Health Plans for Federal Employees* available online to their employees, and effectively encouraged its use during Open Season. The key point is that as much as 75 percent of each enrollee's premium is paid by the employing agency, through its Salaries and Expenses account. While the table is slightly dated, and understates potential USPS savings (where the contribution rate is now as high as 83.5 percent), the potential savings are rather substantial, to say the least. As the table shows, for every employee who switches from one of the dozen highest cost plans to one of the dozen lowest cost plans, the average saving is roughly $2,000. Assuming enrollment choices are stable, which they are in the FEHBP, this is not a one time saving to the agency, but one that continues year after year.

Agency Savings Potential 2010

	Biweekly Govt Contribution		Biweekly Saving from Switch		Annual Saving from Switch	
	Self Premium	Family Premium	Self Saving	Family Saving	Self Saving	Family Saving
Govt Contribution for 12 Highest Cost Plans in DC Area (Maximum Govt Contr)	$167.61	$376.04				
Government Contribution & Savings Under 12 Lowest Cost Plans in the DC Area:						
Mail Handlers Value Option	$82.68	$197.12	$84.93	$178.92	$2,210	$4,650
Kaiser Standard	$100.49	$231.13	$67.12	$144.91	$1,750	$3,770
Aetna Healthfund HDHP	$103.51	$226.68	$64.10	$149.36	$1,670	$3,880
Mail Handlers HDHP	$107.60	$243.81	$60.01	$132.23	$1,560	$3,440
GEHA St	$111.08	$252.41	$56.53	$123.63	$1,470	$3,210
United Healthcare HDHP	$113.38	$253.29	$54.23	$122.75	$1,410	$3,190
APWU CDHP	$116.55	$262.20	$51.06	$113.84	$1,330	$2,960
GEHA HDHP	$131.82	$301.08	$35.79	$74.96	$930	$1,950
United Healthcare CDHP	$135.45	$299.84	$32.16	$76.20	$840	$1,980
Blue Cross Basic	$139.52	$326.75	$28.09	$49.29	$730	$1,280
Aetna Open Access Basic	$145.62	$340.79	$21.99	$35.25	$570	$920
Aetna Healthfund CDHP	$145.73	$347.75	$21.88	$28.29	$570	$740
Average government savings under these 12 plans:					$1,250	$2,660
Average for Self and Family Combined:				$1,960		

I haven't had time to make these calculations more precise for the USPS, or to reflect current postal employee plan enrollments, but a ballpark estimate would be that if one half of postal employees could be persuaded to switch from one of the higher cost plans (over one third are in Blue Cross Standard option, for example) to one of the lower cost plans, 250,000 employees times a USPS saving in excess of $2,000 each would bring in $500 million in savings in the first year alone. And this saving would put employees in good plans, not the stripped down versions the USPS is now proposing.

Here is a simple suggestion: The USPS could offer a two hundred dollar year-end bonus, perhaps as a Health Savings Account, to every employee who made such a switch in the next Open Season.

This is but one option under current law. There are others. For example, the USPS and the postal unions could collaborate on a premium contribution reform similar to the one I recommended in *Putting Medicare Consumers in Charge: Lessons from the FEHBP*. The basic idea is that the government contribution could be 100 of the cost of a lower benchmark, such as 70 percent of the average of all plans' total premium cost. This would actually reduce the employee share of premium for the most frugal plan choices. But it would raise premiums for those in the higher cost plans. Postal workers themselves would decide which plan to choose, from among the wide set of choices offered today (almost two dozen plan options throughout America, not just in the DC area). Over time, workers would gravitate to lower cost plans and the USPS would save a great deal of money.

The Good News About the USPS Retirement Proposal

The one good thing that I see emerging from the USPS proposal is its focus on the growing problem of Medicare/FEHBP premium and benefit coordination.

Medicare was created over 40 years ago, and the FEHBP over 50 years ago. The design of each has not significantly changed since its inception, with the major exception that Medicare has added private plan alternatives and a system of choice based on the FEHBP model in Medicare Advantage, as well as a prescription drug benefit. Original Medicare remains frozen in the time warp of vintage 1960 insurance patterns (e.g., the nonsensical bifurcation between hospital and physician costs, and the failure to use networks to control costs). The FEHBP has aged far more gracefully, with a market driven structure that readily adopts the latest and best insurance practices. But neither program has made any sensible accommodation to the existence of the other.

Absent legislative reform, OPM and the plans have struggled to create some kind of coordination. Unfortunately, the one they chose creates a major problem. All but one of the national fee-for-service plans in the FEHBP offer age-65 enrollees a seemingly wonderful benefit enhancement. The plans promise that if the enrollee has both Medicare Parts A (hospital) and B (physician), all hospital and physician care will be free—no deductibles, no coinsurance, and no copayments. Not only that, all this medical care will be free whether or not the enrollee uses preferred providers—network constraints go away. What could be wrong with this wonderful benefit enhancement? Indeed, the great majority of retirees elect to pay the Medicare Part B premium at age 65, and enroll in one of the national fee for service plans.

This wonderful coverage comes, however, at a high price. In 2012, the total premium cost for the most popular choice in combination with Medicare, Blue Cross Standard Option, will cost a retired couple over $7,500 in premium. This is a "for sure" expense, whether or not they ever see a doctor (of course, total cost is far higher, with most hidden in the government premium subsidies).

This same couple was most likely enrolled in Blue Cross until age 65, and was satisfied with its good benefits and reasonable premium. What changed upon turning age 65 that impelled them to pay an extra $2,400 a year for two Part B premiums? They do get that reduced cost sharing, and the ability to leave the network without penalty. However, *CHECKBOOK's Guide* estimates that in 2012 the net effect of joining Part B is to cost the average retired couple in Blue Cross Standard option more than $1,000, on average. The answer is that this decision is rational for that couple only because existing law is irrational.

Of greater importance to the program and to the United States Treasury, this decision is expensive. That retired couple has no incentive to be frugal in any way in making decisions about any kind of health care other than prescription drugs and dental care. Unlimited provider visits are free. The most expensive provider in the nation is free. The most discretionary surgical procedure is free. Durable medical equipment is free. Every conceivable medical test is free. Thousand dollar MRI and CAT scans are free. If an additional scan would show progress, the price is right for the second.

Based on robust research findings on the effects of cost sharing incentives, each person enrolled in a wraparound FEHBP plan and Medicare Parts A and B costs the Federal government somewhere on the order of 15 percent or more, or $1,500 or more, in unnecessary medical care utilization (for the source of this conservative estimate, see Jeff Lemieux *et al*, "Medigap Coverage and Medicare Spending: A Second Look," in *Health Affairs* Volume 27, Number 2, March/April 2008). With approximately 1.5 million Medicare enrollees (both single and couples), the Federal government loses more than $2 billion a year in increased utilization under the current system. Most of this cost falls on Medicare (which pays first) but as much as a half billion dollars a year falls on the FEHBP. And it falls disproportionately on plans like Blue Cross Standard Option, because they attract a disproportionate number of Medicare enrollees.

Meanwhile, it appears that increasing numbers of age-65 retirees are deciding not to sign up for Medicare Part B. They calculate, correctly, that they will save substantially in most years by not having to pay two sets of premiums. There are alternatives, such as suspending FEHBP enrollment, paying only one set of premiums, and enrolling in a Medicare Advantage plan. Today, all Medicare Advantage plans offer very good value (for example, they all have good catastrophic protection), and paying one premium is far better than paying two premiums. But very few even know this option exists, and even fewer choose it.

The trend of few retirees signing up for Part B will accelerate as more and more higher income retirees face the Medicare income-tested Part B premium penalty (almost all GS-15 or higher-graded retirees who are single will pay the higher income-tested premium if they enroll in Part B). Every such decision actually saves the Federal government money by reducing incentives for wasteful overutilization, but those savings accrue primarily to Medicare, not the FEHBP. The effect on the FEHBP is to raise premiums overall, and especially in those plans that disproportionately attract retirees (e.g., Blue Cross Standard Option and NALC).

FEHBP plans individually and the program as a whole would benefit if many more Medicare-eligible enrollees sign up for Part B. Most of this saving would, however, be offset by wasteful overutilization if current benefit design remains unchanged.

There is a major alternative. Instead of enriching benefits so far as to eliminate all hospital and physician cost sharing, in a decreasingly successful effort to induce Medicare participation, plans could instead directly subsidize Medicare Part B premiums. Ideally (from a government-wide and taxpayer perspective) plans would be strongly discouraged or even prohibited from improving physician and other ambulatory cost sharing, but instead encouraged to add benefits that are not covered by Medicare Parts A and B, such as better prescription drug coverage, vision care, dental care, and improved hearing aid coverage. (That the government's no-cost standalone dental plans would lose business, and that OPM's longstanding policy of discouraging dental benefits would be reversed, should be of no concern whatsoever since hundreds of millions of dollars in actual real savings to both enrollees and the taxpayer would be involved. Alternatively, the dental subsidy could be directed towards "free" enrollment in those plans.)

Viewed from a beneficiary perspective, the ideal result would be no-cost Part B coverage, no change in cost sharing for hospital, medical, and drug benefits based on Medicare coverage (that is, most benefits would be identical pre- and post-65, and modest additional benefits (such as a dental fund or premium subsidy of several hundred dollars) not available pre-Medicare. Take-up would be near 100 percent (why would anyone decline a free benefit?), and all enrollees would directly gain more than they do under the current wrap-around scheme, as well as retaining the ability to go out of network should they so choose, using the Medicare Part B benefit.

Under such a reform, there would have to be a one-time amnesty from the Medicare penalty for delayed enrollment or, better yet, Medicare would adopt the Part D innovation of allowing penalty-free late enrollment for anyone who had been enrolled in comparable or better "creditable coverage." (This last innovation would benefit Medicare in all situations where employers such as State or local governments had rich benefits post-65, as many do.)

Among the other benefits of such a reform, it would encourage retirees to remain in HMO plans, since there would no longer be an advantage for enrolling in national fee-for-service plans. As a result, the FEHBP would benefit from the superior cost control exercised by HMO plans. (At present, about one third of employees enroll in HMOs, but most older retirees migrate to the "free" care of the national plans and less than one tenth of annuitants are enrolled in HMOs.)

Such a program could and should be voluntary. Compulsion is not needed if incentives are properly aligned. Almost any version would be easy for plans to administer, as they currently serve large numbers of retirees both under and over age 65, with every conceivable combination of Medicare coverage, including even a few retirees and survivors in their 80s and 90s who have no Medicare coverage at all.

And if this change were made for the FEHBP program as a whole, the currently required USPS contribution for unfunded retiree health care costs would decrease substantially, thereby directly benefiting the solvency of the USPS without massively disrupting either the FEHBP and its 8 million enrollees and dependents, or reneging on retirement promises made in law to current postal retirees.

Conclusion

If Medicare/FEHBP benefit and premium coordination are not reformed, the FEHBP is likely to see costs surge over time. I urge the Congress to think "out of the box" in assessing the current state of the FEHBP and possible reform options like these. There is plenty of practical and analytic help to be found in the CBO, OMB, GAO, and OPM itself. I wish you success in making needed reforms to this vital program. It is not aging well, and the USPS proposal, while badly flawed, demonstrates the importance of reform for the program as a whole.

It is clear that the main goal of the USPS is to reduce its costs of financing retiree health costs, and the USPS is apparently even willing to take on the substantial financial burden of an aging and increasingly expensive work force to get that relief. But it is neither necessary nor sensible to do anything remotely so drastic as dismantling the FEHBP to achieve the savings it needs, and possibly even higher savings.

Thank you for the opportunity to testify today.

Mr. ROSS. Thank you, Mr. Francis. I appreciate your energy, especially your expertise in this area, and I will now recognize myself for five minutes.

I want to talk about prefunding for a quick second because you touched on that. Are you suggesting then because it is simply not true that everything is being set aside that it is really an obligation to pay an IOU, if you will, in a trust fund, that we all just call it what it is and eliminate it entirely and tell the American taxpayers that they are going to be on the hook for the unfunded liabilities of health care and retirement benefits?

Mr. FRANCIS. I don't know the best answer to that, Mr. Chairman. A couple of points. First, if we reform the Medicare interface, that alone will substantially reduce. The part of what you heard from the Postmaster General is correct. So the unfunded liability can be greatly reduced if you can get more Federal retirees to enroll in Medicare Part B. That is sort of Point A.

Point B, a lot of this may hinge on scoring rules and so on. I think the Congress enacted this prefunding requirement about four or five years ago, as I understand it, in the expectation that the Postal Service might go insolvent, so we better get these funds before it is too late. And then it has turned out that the prefunding itself has been the single biggest cause of the Postal Service's budget hemorrhaging——

Mr. ROSS. Which, of course, it isn't. There are systemic——

Mr. FRANCIS. Well, you are right.

Mr. ROSS. Given the $5 billion or the $5.8 billion, they are still showing over a $5 billion annual loss. It has nothing to do with prefunding.

Mr. FRANCIS. Right.

Mr. ROSS. But be that as it may, also on the Medicare issue, Mr. Donahoe mentioned that he is the second largest employer that contributes to Medicare and, therefore, there should be some benefit for that contribution. How do you reconcile that?

Mr. FRANCIS. Well, it just sounds like strange writers to me. First, he is not the second largest. How about the civilian side of the Federal Government? I mean, don't they count for something. View from a business perspective I am not going to argue with his point, but what he is doing and the employees are doing—and, by the way, economists all believe that the entire burden of the Medicare Part A tax is paid by employees. It effectively comes out of wages, okay?

The Postal employees are paying into a Medicare Part A trust fund and they are going to get free Medicare Part A when they retire. That is the deal. There are problems with that deal, but they are not Postal Service problems. There is nothing special about what the Postal Service is doing; that is the system for every employer in America.

Mr. ROSS. Obviously, we are here because we want to talk about the proposal on the health care benefits, but that is more of a symptom of the major problem. The major problem is that there is a problem within the Postal Service that requires reorganization and reformation. One of the issues that we have to address, of course, is their labor costs. Over 80 percent of their cost is labor. How do you recommend that we handle that?

Mr. FRANCIS. This is a similar problem, no, actually, it is a common problem.

Mr. ROSS. It is the $60 million question.

Mr. FRANCIS. This is what Rhode Island faced and had to take really drastic action to reduce public employee pensions and health benefits. I don't know the right answer. Is the Postal Service——

Mr. ROSS. But you would agree we have to address the labor cost, right?

Mr. FRANCIS. Oh, absolutely. No question about it.

Mr. ROSS. Because if the revenue side of the equation continues to decline, even if it stays static on the expense side, we are going to have further and further shortfalls.

Mr. FRANCIS. Yes. And I have no sense of whether Postal employees are overpaid or underpaid by any metric, but clearly reducing labor costs is a vital thing for them to do. But I want to be clear. For employees they are going to increase labor costs. Their proposal is not going to save money, it is going to cost money.

Mr. ROSS. Let me throw out something. In your written testimony you talk about a health savings account and a contribution. So you believe that maybe there is even a more innovative way to stay within FEHBP and just change the way we do it, and have the Postal Service contribute less but more by ways of an HSA?

Mr. FRANCIS. Absolutely. They could go ahead and give health savings accounts to employees who sign up for Part B. That is another area we might have to change the law——

Mr. ROSS. So, in other words, we could reduce the cost because the premium would be reduced, and yet increase the amount we put into an HSA and have a net decrease of what we are investing in health care?

Mr. FRANCIS. Yes. That could be done tomorrow, assuming there is no legal impediment on the Ways and Means side. I don't know of any other legal impediment.

Mr. ROSS. One last thing. You indicate that the USPS finds itself in a predicament that is primarily the result of one flawed statute that enables the Congress of the United States to micromanage what should be a business decision. Any suggestions in the next 30 seconds that you would offer how we make that a more flexible statute so that there would be more flexibility to the Postal Service?

Mr. FRANCIS. I think the proposals that were discussed, that are in the bill that you discussed with the Postmaster General, all sound to me perfectly reasonable. I think the flexibility to close processing centers and post offices is very important, but it is not probably as important as some of the other things discussed. I think he has a great plan, and I hope the Congress enacts all of it but this piece.

Mr. ROSS. One last quick question. Have you had a chance to consult with the Postmaster General on any of his proposals?

Mr. FRANCIS. Only a few seconds before and after his testimony, sir.

Mr. ROSS. Thank you, Mr. Francis.

Mr. CONNOLLY. There are a lot of us in Congress in the same position.

Mr. ROSS. Okay, I recognize the gentleman from Virginia, Mr. Connolly.

Mr. CONNOLLY. Thank you, Mr. Chairman, and thank you, Mr. Lynch, for your courtesy. I have to run to the steps of the Capitol, so I really appreciate it. I have a middle school group of 200 kids.

I want to welcome Mr. Francis, who deservedly has the reputation for being the walking expert on these matters, and I thank you, Walt, so much for being here today. If I understood your testimony, let me get this straight, now. If we were to adopt, whole and entire, the Postmaster General's proposal with respect to health care here, it would actually cost the Postal Service a half a billion dollars, that transition, because they are now beneficiaries of being in a larger pool and, therefore, they are subsidized?

Mr. FRANCIS. Correct.

Mr. CONNOLLY. Would it be a half a billion every year or just a one-time hit?

Mr. FRANCIS. It would grow over time, because——

Mr. CONNOLLY. Grow over time?

Mr. FRANCIS. Yes, sir. Because they already have an aging workforce that is much more aged. The crucial point is a 50-year-old, on average, in this Country costs something like $8,000 a year in health care, and a 20-year-old costs something like $2,000 a year in health care. They aren't going to be hiring any more 20-year-olds for at least a decade to come. Leave aside those retiring. The existing workforce will keep aging, will be more expensive every year. The best thing they could do is stay in that FEHBP pool. It affects the cross-subsidy from the younger and healthier ones being hired.

Mr. CONNOLLY. So, golly, gosh darn, a proposal allegedly designed to save money will cost money. And, by the way, as we discovered in the study the Postmaster General and his senior management team commissioned and then deep-sixed because they didn't like the results, it is a similar situation where some of the other so-called reforms that apparently would cost $5 billion in lost revenue, more than offsetting the savings. So here we have another example.

Let's assume, let's stipulate good intention, but the analysis does not hold up. We are going to lose money, and I am shocked. That loss of a half a billion grows over time because of the aging workforce and the fact that newer, younger folks aren't come in because of the shrinking of that workforce.

Mr. FRANCIS. That is the case.

Mr. CONNOLLY. Now, you also said a second problem with this, I am sure also unintended, is that we are going to have one heck of a penalty on widows and other survivors who currently aren't signed up for Medicare A and B. And the reason there is an $8,000 per person penalty or cost is because they actually have to pay a certain penalty, don't they, under Social Security?

Mr. FRANCIS. Yes, sir. Let me just be clear. Under current law, if you do not have Part A through the normal post-employment way that you get it, and there is a large number of people in this Country, several hundred thousand, who don't have it you get to pay the princely premium for signing up for Part A of around $5,000 a year. Now, I have never heard of anyone paying that, actually, I have, but there aren't many who would pay that. But the proposal, as written, says they are going to force, now, actually hidden in——

Mr. CONNOLLY. So it will be an individual mandate.

Mr. FRANCIS. Oh——

Mr. CONNOLLY. My goodness, Mr. Chairman. I can't imagine the Subcommittee——

[Laughter.]

Mr. FRANCIS. Part B has a penalty of 10 percent a year for every year you could have signed up after age 65. So say you are an 80-year-old widow. You have 15 years of 10 percent a year penalty if you sign up for Part B. And, again, you could change the Social Security Act to get rid of those penalties——

Mr. CONNOLLY. So, given my brief time, Walt, it is going to cost a half a billion dollars a year to the Postal Service, hardly saving money, and that grows over time. We are going to penalize widow ladies to the tune of about $8,000 per widow, and there are tens of thousands of them because, again, of the nature of the workforce and the retiree demographics.

Now, a third consequence from this proposal, of course, is an FEHBP itself, is it not? It reduces the risk poll rather considerably, given the size of the Postal Service.

Mr. FRANCIS. It will be a cosmic change.

Mr. CONNOLLY. Cosmic?

Mr. FRANCIS. Well, to give you a simple example, two examples. A lot of the HMOs that participate in the FEHBP are in cities where the main part of the Federal workforce is Postal, okay? Guess what happens in those cities? Insurance is going to say it is not worth doing business. We used to have 1,000 enrollees, now we are going to have maybe zero or maybe a few hundred. So they are going to pull out.

So a lot of people who are not Postal employees are going to lose that access. I think it is unlikely that any of the Postal plans would survive this. It is possible, but almost all the Postal plans predominantly enroll either current Postal employees or retired Postal employees, and they are not going to be allowed to enroll either group.

Mr. CONNOLLY. So other than that it is a great idea.

My time is up, Mr. Chairman, but I just want to cite H.L. Mencken, who once said that for every human problem there is a solution that is simple, neat and wrong. The Postmaster General's proposal on health care fits that description.

Mr. ROSS. Thank you.

I now recognize the Ranking Member of the Subcommittee, the gentleman from Massachusetts, Mr. Lynch, for five minutes.

Mr. LYNCH. Thank you, Mr. Chairman.

Thank you, Mr. Francis, for your willingness to come and help this Committee with its work. The idea of insurance usually or generally is that you spread the risk of harm or illness over a wide population so that what happens is the healthy folks, which is the majority of people, subsidize the cost to those of us who get sick. That is how insurance generally works.

The way the Postmaster General was describing it today was that we were going to concentrate the risk. In other words, if an individual participant was just by themself, they would pay less. They would pay less. A husband and wife would not have to pay a family plan, they would pay less. And it would, by its nature, concentrate more of the risk on the very individuals who might be the sickest.

Have you looked at that aspect of the proposal?

Mr. FRANCIS. Yes, I have, sir. The key factor here is that people pose very different risks at different ages. By the way, the OPM actuaries have actually looked at this question because it has many times been proposed that, for example, there be a rate for couples. I counsel thousands of people very year and they will raise their hand and say we are a married couple, we are 50 years old, we don't have all those kids; why can't we get a rate just for us? And the answer is because that young couple with kids is cheaper than you, and if you were in a separate pool you would pay more, a lot more. And I give an example in my testimony of how it could be double.

The FEHBP pool of 8 million people, the 20-year-olds are paying a lot more than they would if they were in a separate category, okay, to be sure. And it is very interesting how this all plays out. And, by the way, back to the Medicare point, 65-year-olds with Medicare Parts A and B, they often complain why can't we get a lower rate because we are cheaper? And they are right, because Medicare is primary and they cost less than those 64-year-olds.

So the FEHBP says we are going to spread it across everybody and we are not going to try to chop it up in pieces, and the Postal proposal would not only reduce the pool from 8 million to 2 million people, it would, by creating four premium paying categories, may make a lot of people pay more than they pay today; others would pay less.

Mr. LYNCH. Okay. Thank you. Thank you for that. The other question I had is regarding the Affordable Care Act. Under the Affordable Care Act, one of the key funding provisions for the Affordable Care Act is that in 2018, if you have an expensive health care plan, then in 2018 you are going to be hit with a 20 percent tax on the value of your health care plan. Not how much you use, but the value of your health care plan. Now, just for the record, I voted against the Affordable Care Act, and that was one of the key reasons why, because we never used to tax health care because we wanted people to have it. It is kind of like taxing food. We would never taxed food in this Country because you would starve without it.

Well, the way it looks right now, what the framework of FEHBP and, most likely, this Postal plan that the Postmaster General has suggested, it would a Cadillac plan based on the costs now and the estimated increases until we reach 2018. And there is a reason it comes into effect in 2018, because the folks that pushed it will all be gone and they won't have to answer for this. So have you thought at all about this 20 percent tax on expensive high-end health care plans and what it might mean for this Postal plan if it is separated from FEHBP?

Mr. FRANCIS. I hadn't, Congressman, but you are absolutely right, it is a potential problem of significant proportions. That provision of the law, by the way, in the Affordable Care Act ties that number to the cost of the Blue Cross plan in the FEHBP. What will happen, I think, and I am just thinking on my feet on this, actually, the high value Postal plan, the one they say is equal to, it isn't, it is actually inferior. For example, it has lower benefits than Blue Cross standard option.

Nonetheless it is pretty close in benefits to that. It is going to disproportionately attract the older and sicker Postal employees. They are all going to be in that group by then, pretty much, and, yes, that plan will cost more than Blue Cross standard option in that year, I think, that would be a reasonable projection, and that tax will hit Postal employees.

Mr. LYNCH. Okay.

Mr. FRANCIS. Or the Postal Service.

Mr. LYNCH. All right. I see I have exceeded my time. I appreciate you coming before the Committee and helping us with our work. Thank you, Mr. Francis.

I yield back.

Mr. ROSS. Thank you.

I now recognize the gentleman from Illinois, Mr. Davis, for five minutes.

Mr. DAVIS. Thank you very much, Mr. Chairman.

Mr. Francis, do you see any redeeming value in the Postmaster General's self-run plan or do you see anything about it that you like?

Mr. FRANCIS. Well, I hope I am clear. There is one huge redeeming value, sir, and that is the focus on the need to reform the interface between Medicare and the FEHBP. And while he wants to make it compulsory and I would quibble with some other details of it, he innovatively includes Part D in that calculus. I was pleased to see that. I hadn't, even myself, focused on the Part D side. But the thinking there is good, it is a basis for thinking about the entire FEHBP, and that is the part that is most important to the Postal Service.

I find it hard to believe that they really think running their own plan is going to save any money, but, regardless, it won't. But fixing the interface between these two programs, they have been going along side-by-side for 50 years and no one has ever adjusted either program, Medicare or the FEHBP, to take account of the other. It is almost bizarre. No administration, no OPM director. I am not criticizing Mr. Barry in particular, this Administration in particular. It is time for the Congress to take a hard look at reform angles. So that is where I see the positive in this.

Mr. DAVIS. But you answered the other question that I had relative to cost savings, and it is your position that it would not save any money.

Mr. FRANCIS. It is my position that it not only would not save money; it would cost more. Quite apart from the extra cost of the older and sicker enrollees, Mr. Lynch had stepped out and didn't hear my point about the premium thing for prescription drug point, which I know is of particular interest to you, sir. They are saying, and if you look at this Hay report, they will say, I forget the number, the bulk of their projected savings come from they are going to bargain better for prescription drugs in their 2 million enrollee plan.

Well, the Blue Cross carrier with two plans today enrolls 5 million people. So the notion that mere size, that is illusory. It is preposterous to say that just because they have a plan with 2 million people they are going to save money. In fact, I am, frankly, skeptical. I think OPM does a superb job in managing the FEHBP in terms of keeping the plans honest and frugal, and I have no reason to think the Postal Service has that competence.

Mr. DAVIS. I must admit that with a limited pool and with not as many subscribers or beneficiaries or individuals in the pool, it is difficult for me to see how, unless you had a pool that you could select out or cherry pick, I just couldn't see the money saving. So let me just thank you for coming to share your views with us. I appreciate it.

I have no further questions, Mr. Chairman, and I yield back the balance of my time.

Mr. ROSS. Thank you, Mr. Davis.

Just real quickly. I will go briefly and then I think Mr. Lynch wants to go also.

As I understand it, if the employees of the United States Postal Service had paid for their health care at the same amount that the other Federal employees had, then the Postal Service would be showing a half a billion profit?

Mr. FRANCIS. Yes. But let me restate it, sir, if I may. Yes, they have been, if you will, I hate to say overpaying because these were union negotiated rates.

Mr. ROSS. Right.

Mr. FRANCIS. But they have been paying about 10 percent a year more than the rest of the Federal Government every year for the last 20 years or so.

Mr. ROSS. The Postal Service has been paying that.

Mr. FRANCIS. The Postal Service has. They could have saved multiple hundreds of millions of dollars every year.

Mr. ROSS. If we had just let them pay—if we let the employees of the Postal Service pay what the Federal employees were paying.

Mr. FRANCIS. Exactly.

Mr. ROSS. Which begs the question that it is such a sweetheart deal that it is almost killing the goose that is laying the golden egg.

Mr. FRANCIS. Yes. And it doesn't give one confidence that they know what they are doing, though I must say this Postmaster General is a bright light compared to——

Mr. ROSS. I agree with you. I agree with you. I think he has done an outstanding job in recognizing the problems and realizing that something has to be done. He is very innovative.

Mr. Francis, I am grateful to you for your testimony today. I hope that you do get a chance to work with Mr. Donahoe on this because I think you bring a lot of things to the table.

With that, I will recognize Mr. Lynch.

Mr. LYNCH. Thank you, Mr. Chairman.

Recently, Mr. Barry, the Director of OPM, has suggested that the 9 million people, Federal employees, who are right now in the FEHBP, the Federal Employee Health Benefit Plan, prescription drug program, he has suggested that that 9 million be taken out of that program so that they be allowed to use a competitive process to pick a plan, pick their own drug benefit plan and could probably get a better deal, because they are being overcharged right now in the FEHBP, but they are a captive group. What do you think about that proposal?

Mr. FRANCIS. Congressman, I know it is probably near and dear to your heart, but I am against it, and let me tell you two reasons. One, let's assume it is correct that there somehow OPM could bargain better than Blue Cross. I am not at all convinced with——

Mr. LYNCH. Well, no. They are suggesting that individuals be given the power.

Mr. FRANCIS. Oh, I thought they were talking about a single drug contract. But let me just say, assume some money could be saved. The problem is this: you want to have a drug benefit integrated with the hospital and doctor benefit. It is less important that you may be paying $21 for a certain pill instead of $20, or vice versa. That is a lot of money for a lot of people, but compared to, hey, if this plan is able to make sure you take that pill and stay out of the hospital, that is where the big savings are.

So you really want the health plan to be managing all the pieces at once. That is disease management; it is done quite well, I think, by many health plans, but not by all, and that is the wave of the future. All the Medicare reforms that this Administration is making, accountable care organizations and so on are all aimed at that same idea. We want people to look at the totality of costs and services that a person gets and minimize cost and maximize their health.

Mr. LYNCH. Well, thank you, Mr. Francis. Not the answer I was looking for, but I certainly give you credit for that. Thank you.

Mr. ROSS. Thank you, Mr. Francis, for being here.

That concludes our witnesses' testimony today. I appreciate your taking the time from your busy schedule. Thank you for your input and the Committee now stands adjourned.

[Whereupon, at 12:15 p.m., the subcommittee was adjourned.]

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Committee on Oversight and Government Reform

Subcommittee on Federal Workforce, U.S. Postal Service and Labor Policy

"Can a USPS-run Health Plan Solve Its Financial Crisis?"

March 27, 2012

Thank you Mr. Chairman. The Postal Service recently issued its five-year "Plan to Profitability," in which it proposes achieving $20 billion in savings by 2015. The Postal Service estimates that it can achieve $10 billion in cost savings without legislation, but it will require Congressional action to realize the remaining $10 billion in savings. According to the Postal Service's plan, the bulk of those savings—$7 billion—would be realized if Congress authorized the Postal Service to take its employees and retirees out of the Federal Employee Health Benefits Plan (FEHBP) and put them into its own health care plan.

Currently, FEHBP covers more than 9 million federal employees and their families nationwide. Employees enrolled in FEHBP can choose from among 200 different health care plans. The Postal Service contends that it could manage employee health insurance better than the federal government as a whole.

I want the Postal Service to succeed in the long run. I believe the Postal Service serves a unique and irreplaceable function in our society, and that it is a necessary part of our nation's economic and social future.

But I am skeptical that the Postal Service can or should manage its own health insurance. I suspect that the achievable cost savings would come not from shrinking health care costs, but from shifting them onto employees. Postal employees would likely receive less coverage under a Postal Service plan, and they would pay a greater share of their health bills. Postal annuitants would also pay more, as they would be faced with paying an increasing share of their health care from their fixed retirement incomes.

I look forward to hearing from the Postmaster General today about this proposal and about these concerns. I also want to hear from him how he is going to grow the Postal Service's business, and what new authority he needs from Congress in order to make the Postal Service as relevant to America's future as it was to our past.

February 10, 2012

United States Postal Service

Retiree Health Benefits

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Executive Summary

The United States Postal Service (USPS) is one of the largest employers in the nation, with over 500,000 full-time employees. It provides healthcare coverage to all eligible employees and retirees and their dependents.

Currently, Postal Service employees and annuitants participate in the Federal Employees Health Benefits Program (FEHBP). Annuitants share the cost of coverage and can choose from among over 200 health plans and two levels of coverage (self or self & family). The Postal Service has contributed to the Postal Service Retiree Health Benefits Fund (PSRHBF) with the amount of assets currently greater than the present value of future costs for current annuitants but less than the liability for current and future annuitants.

This report provides the Postal Service with estimates of the retiree healthcare liability and funding amounts under the USPS proposed health plan.

The starting point for the projections was the most recent measurement of the obligations prepared by the Office of Personnel Management's Office of the Actuary.

Appendix A describes the current plan provisions and Appendix B is an actuarial certification.

Assumptions

Funding Method

The funding forecast assumes the USPS retains the PSRHBF assets, with the assets restricted to Special Issue government bonds. These are the same asset classes in which the Federal Employees Retirement System (FERS) and Civil Service Retirement System (CSRS) funds are invested. From a funding perspective, the liabilities and funding amounts have been determined using the interest rate consistent with the rate used for funding FERS and CSRS (i.e., a 5.75% interest rate).

The Postal Accountability and Enhancement Act of 2006 (PAEA) language uses a declining 40-year period for amortizing the unfunded actuarial accrued liability. The funding costs are determined using this same basis; that is, funding consists of the Normal Cost plus an Amortization Payment, developed as the amount needed to fund the Unfunded Actuarial Accrued Liability over a closed period of 40 years in level annual payments, starting September 30, 2013.

Workforce Projections

The forecasts are based on the workforce demographic assumptions employed by OPM's Office of the Actuary (OPM OOA) in their determination of the year-end accounting disclosure of the USPS retiree healthcare liability, with one primary modification. In developing our workforce projections, we have taken into account the proposed legislative incentives that provide increases in pension credits or cash incentives for employees to retire early. To account for the acceleration in retirements we have increased the expected number of retirements by 2013 from a total expected retirements under standard assumptions of 61,593 to 102,938. For ease of reference, we refer to these workforce projections in the report as "Accelerated Retirements".

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Liability and Funding Forecast

Table 1 below shows the projected liability and funding requirement using the funding assumption and accelerated attrition.

Table 1 - USPS Retiree Health Benefits Elements
Funding Assumptions
Assumes Accelerated Retirements
(Amounts in $millions)

Scenario	Assumptions	2013 Liability	2013 Assets	2013 Unfunded Liability	2013 Funding
Current Law	Accounting Liability Continued participation in FEHBP and declining workforce. No additional prefunding payments in 2011, 2012, 2013	$102,291	$48,963	$53,328	$8,699
	Change from Federal accounting standards to OPM OOA funding assumptions	$91,040	$48,963	$42,077	$8,699
USPS Health Plan in 2013 (Element 1)	Non Medicare Annuitants and Survivors assumed to enroll in Medicare A and B with no penalty	$74,830	$48,963	$25,867	$4,112
USPS Health Plan in 2013 (Element 2)	Includes Element 1, and additional savings arising from EGWP + Wrap plan for Post- 65 Enrollees.	$53,903	$48,963	$4,940	$2,191
USPS Health Plan in 2013 (Element 3)	Includes Element 2, and revised four tier retiree contributions	$59,434	$48,963	$10,471	$2,719
USPS Health Plan in 2013 (Element 4)	Includes Element 3, and additional savings of 8 percent for Pre-65 retirees from Purchasing	$57,538	$48,963	$8,575	$2,526
USPS Health Plan in 2013 (Element 5)	Includes Element 4, and savings due to Future Retirees having Carve-out.	$50,385	$48,963	$1,422	$1,753
USPS Health Plan in 2014 (Element 6)	Includes Element 5, and savings due to Future Retirees having frozen subsidy at 2013 level.	$39,314	$48,963	($9,649)	$1,089 [1]

[1] Reduced to $489 million if the excess of assets over liability is amortized.

Benefit Cost Modeling

The sections below describe the programmatic changes to retiree healthcare coverage.

Assumptions used in the development of the results in the above table:

The modeling used the current census data for annuitants, survivors, and active employees provided by OPM's Office of the Actuary.

Medicare Parts A and B – Element 1

Annuitants and survivors over age 65 are assumed to enroll in Medicare Parts A and B with no penalty. The savings associated with this change were modeled by pricing the cost of coverage using the "Medicare primary" per capita claims costs. The current costs for these participants are measured using the "Non-Medicare" per capita claims costs. This change only impacts current annuitants eligible for but not enrolled in Medicare. A small number of older annuitants who when they retired were not eligible for Medicare will remain non-Medicare. Future retirees are already assumed to enroll in Medicare Parts A and B. This is illustrated in the following table.

Per Capita Claims Cost by Medicare Status			
	Non-Medicare	Medicare	Savings
Self	$10,588	$4,871	$5,717
Family	$17,707	$10,503	$7,204

Medicare Part D – Element 2

The second program element models the impact of participating in a Medicare Part D Employer Group Waiver Plan (EGWP). This lowers the employer share of the per capita claims cost for annuitants and survivors over age 65. The savings from enrolling in an EGWP plan are expected to be $1,200 per member per year in 2013. The exhibit in Appendix D was presented by Towers Watson at the 2011 Conference of Consulting Actuaries shows an estimated value of $1,227 for 2013. These savings were calculated for current annuitants who are either enrolled in Medicare Parts A or B, or are eligible for enrollment in Medicare Parts A or B. A small number of older annuitants who when they retired were not eligible for Medicare will be excluded from the Medicare Part D EGWP.

USPS Health Plan Coverage Tiers– Element 3

The third program element models the impact of establishing a USPS health plan for both current employees and current annuitants. The USPS health plan will include three self-insured health plans. Appendix B shows the illustrative plan designs for the three plan levels (high option, middle option, value option).

The USPS Health Plan will provide four coverage tiers:

- Self Only
- Self & Child(ren)
- Self & Spouse
- Self & Family

Element 3 measures the impact of moving to four coverage tiers, and setting the cost for Medicare primary participants based on the blended USPS health plan costs. For annuitants who either currently have or are expected to have coverage other than Self Only, a blended contribution rate was determined using an assumed distribution of 60 percent Self & Spouse, 10 percent Self & Child(ren), and 30 percent Self & Family. Current data does not include a breakdown of Self & Family, so this distribution was selected based on an examination of other larger employers' retiree enrollment data with similar employer subsidy levels. For the purpose of this calculation, 60 percent of retirees are assumed to participate in the high option plan, 12 percent of retirees are assumed to participate in the middle option plan and 28 percent of retirees are assumed to participate in the value option plan. This distribution of enrollment by plan option mirrors the current FEHB enrollment. Since the contribution required of participants is being reduced, that has the effect of increasing the liability compared with current law.

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The following table shows the bi-weekly contribution rates by tier for the three different plan options.

Plan	Self Only	Self & Spouse	Self & Child(ren)	Self & Family
High Option	$70.52	$146.80	$118.69	$192.97
Middle Option	$50.22	$104.16	$83.91	$136.70
Value Option	$41.57	$86.74	$69.76	$114.05

USPS Health Plan – Element 4

The fourth element models the impact of lower claims costs for non-Medicare retirees under a single procurement health plan. For modeling purposes we have assumed no change in claims costs for Medicare-eligibles and an 8 percent reduction in non-Medicare claims costs.

The estimated 8 percent reduction in cost is made up of the following components:

- Administrative cost savings
- Prescription Drug Contract savings
- Increased purchasing power and Network Discounts
- Wellness and Disease Management savings

We are confident that the administrative fees for a separate USPS plan will be lower than the current expense loads in FEHB. With the large number of FEHB plans, there are many redundancies including plans each purchasing their own claim processing systems, fragmented claims and utilization reporting, and a complex enrollment, data management and tracking process. It is estimated that cost will be approximately 0.8% lower for reduced administrative expenses.

In FEHB, each FEHB plan does its own contract negotiation with a PBM for just the members covered by their plan. There is no leveraging of the entire FEHB population to provide the lowest cost possible. It is certain that a USPS health plan with an estimated 2 million covered lives would be able to achieve savings in prescription drug purchasing compared to FEHB plans today that cover as few as 50,000 members. Based on our experience with prescription drug procurements and coalition pricing, we estimate a 2% reduction in overall cost for a consolidated PBM contract.

Similar to prescription drug purchasing, many items associated with the administration and management of a health plan are priced based on economies of scale. Purchasing power in FEHB is dissipated across numerous plans with significant duplication of services that could be more cost effectively provided by a single vendor. In addition to consolidated purchasing, a separate USPS plan will be able to review and negotiate the best possible medical claim discounts currently available in the market and ensure these discounts by negotiating network discount guarantees with the selected vendor. We have estimated that negotiating current best in class discounts and consolidated purchasing will result in a cost savings of 4%.

In FEHB USPS employees and retirees are enrolled in numerous health plans with no coordinated focus on chronic care management. A separate USPS plan would review USPS specific claims data and working with USPS and our consultants we would design a customized disease and chronic care program to better manage the health of USPS employees and retirees. The expected ROI for well-managed programs averages 2.2:1 based on a health plans book of business. USPS estimates a 1% savings for implementing a comprehensive and targeted disease management program.

Claims Adjudication for Future Retirees – Element 5

The fifth element models the impact of changing the claims adjudication for future retirees from Coordination of Benefits (COB) to "Carve-out". This only impacts employees who retire after 2013, and maintains the plan deductibles and coinsurance payments for all retirees, regardless of Medicare status. For modeling purposes, the carve-out administration is expected to result in an 18 percent reduction in the claims costs for Medicare retirees, by retaining the same copays, deductibles, and coinsurance, etc, that is applied to non-Medicare claims. This estimate was developed using actuarial models and validated using current per capita claims costs for large plan sponsors that use carve-out for their claims adjudication.

Frozen USPS Subsidy – Element 6

The sixth element models the impact of a frozen USPS subsidy for Post 2014 retirees. In modeling this element, we have assumed that starting in 2014 USPS will place a dollar cap on its subsidy in terms of 2014 dollars for retirees retiring on or after January 1, 2014.

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Appendix A: USPS Current Plan Provisions

The USPS participates in the Federal Employees Health Benefits Program (FEHBP), which offers employees, retirees and their survivors a selection of health care plans. USPS employees who are eligible, as well as their eligible family members and survivors, may continue health care coverage in FEHBP at retirement. The following describes the provisions of FEHBP for USPS retirees.

Eligibility

USPS employees may continue health care coverage at retirement if the following requirements are met:

1. The employee retires on an immediate annuity, which begins no later than one month after date of final separation; and
2. The employee has been enrolled in the health benefits program:
   a. for five years immediately preceding retirement, or
   b. if less than five years, enrolled for the full period in which eligible for coverage.

An employee who is covered by the Federal Employees Retirement System (FERS) and is eligible for an immediate annuity at separation from USPS service may postpone receiving his or her annuity to avoid the age reduction. Retirees who elect to postpone their annuity and meet the above eligibility requirements for continuing health care coverage may reenroll at a later time when they begin to receive the postponed annuity.

Other employees who retire early from CSRS/FERS and begin receiving deferred annuity benefits at age 62 are not eligible to enroll in FEHB.

The eligibility conditions for FERS and CSRS are as follows:

An employee is eligible for retirement if the employee meets one of the following age and service requirements:		
CSRS Employee Age is at least	FERS Employee Age is at least	And Creditable Service is at least
62	62	5 years
60	60	20 years
55	MRA	30 years

MRA (Minimum Retirement Age) varies by date of birth from 55 for employees born before 1948 to 57 for employees born after 1969.

Spouse Eligibility

Spouses of retirees are eligible to continue health care coverage as long as the USPS retiree was enrolled in family coverage while an employee immediately prior to retirement.

In addition, surviving spouses and children (survivor annuitants) and former spouses of deceased USPS employees receiving survivor annuities may continue coverage as well. If the surviving spouse or former spouse remarries, the spouse will continue to be eligible for coverage if:

1. the spouse remarries before age 55 and the spouse was married to the deceased USPS retiree for 30 years or more; or
2. the spouse remarries after age 55.

Dependent Eligibility

Eligible dependent children include:

1. Unmarried dependent children under age 26, including:
   - legally adopted children, stepchildren, foster children and recognized children born out of wedlock who live with the retiree; or
   - those covered by a court order to provide coverage to show that the retiree provides regular and substantial support for child; or
2. Unmarried disabled children age 26 and over incapable of self-support because of a disability that began before age 26 (and is expected to last more than one year).

Enrollment

Eligible retiring employees must make a positive election at retirement to continue their health care enrollment. The Office of Personnel Management (OPM) makes the final determination of eligibility for health care enrollment as a retiree. Retirees are entitled to the same health benefits as active employees.

The main types of health care plans are Fee-for-Service (FFS) and Managed Care plans. The insurance carriers and plans available to choose from vary among the states. The options that a retiree has will depend on where he or she lives.

The FFS plans offered are Preferred Provider Organizations (PPO) plans. Under a FFS plan, the insurance carrier contracts with a network of providers to provide services to plan participants at negotiated fees. These FFS plans have two benefits levels, in-network and out-of-network. In-network benefits have lower out-of-pocket costs to plan participants. Out-of-network benefits have higher out-of-pocket costs. These plans are designed to encourage plan participants to use the participating providers.

The managed care plans are Health Maintenance Organizations (HMO). HMO plans only offer one level of benefits. Plan participants must coordinate all of their care with their designated primary care physician and use participating providers in order to receive benefits under the plan. The services received are subject to plan copayments.

In addition, some of the health care plans available may have two options. For example, a retiree may choose between a Standard Option PPO plan and a Basic Option PPO plan from Blue Cross/Blue Shield. The benefits vary in coinsurance, copayments and deductible amounts. Not all plans available will have both a High Option and Standard Option.

Retirees are able to change their health care coverage. They may change coverage during the FEHBP open season or during the year if they experience a qualifying life event, such as change in family status (e.g., marriage, divorce, birth, death), becoming eligible for Medicare, or if the retiree moves out of the service area of his or her plan.

Retirees enrolled in FEHBP who become eligible for Medicare will not have their FEHBP coverage terminated. However, they may elect to cancel FEHBP enrollment if they are enrolling in a Medicare Advantage plan. They may then reenroll at a later time if they choose to cancel their Medicare Advantage plan enrollment.

Coverage

There are only two types of coverage options:

- Self Only (Self)
- Self and Family (Family)

Retirees may continue to cover their eligible dependents only if they were enrolled in Family coverage immediately before retirement. However, if a retiree has Self coverage and acquires a new dependent (through marriage, birth, adoption, or foster child), he or she may change from Self to Family coverage due to the qualifying life event.

Retiree Contribution

The retiree is responsible for the difference between that USPS premium contribution and the premium rate of the health care plan option elected. The retiree contributions are deducted from annuity payments.

The cost of health care coverage is shared between the annuitants and the USPS. For retirees whose full career was with the Postal Service, USPS will pay 72 percent of the weighted average premiums of all the health care plans under FEHB Program, limited to 75 percent of the premium rate for any given health care plan option. Thus, if a retiree is enrolled in a health plan whose premium is greater than the average premium, the USPS pays 72 percent of the weighted average premium and the retiree pays the balance. If a retiree is enrolled in a health plan whose premium is significantly lower than the average, the USPS pays 75 percent of the actual plan premium.

Table A-1 illustrates how these rules apply to different health benefit plans. The table shows that the USPS portion of the premium can vary from as low as 47 percent to as high as 75 percent.

Table A-1 — 2011 Monthly Premium Rates for Future Retirees — Self Coverage

Plan	Monthly Plan Premium	72% of Average FEHBP premium	75% of Plan premium	USPS Portion [smaller of (3) or (4)]	USPS Portion as a percent of Plan Premium
(1)	(2)	(3)	(4)	(5)	(6) = (5) / (2)
Blue Cross And Blue Shield Service Benefit Plan [Standard Only]	$578.61	$391.43	$433.96	$391.43	67.65%
Blue Cross And Blue Shield Service Benefit Plan [Basic Only]	$453.48	$391.43	$340.11	$340.11	75.00%
Mail Handlers Benefit Plan - Standard Option Only	$611.20	$391.43	$458.40	$391.43	64.04%
Rural Carrier Benefit Plan	$565.83	$391.43	$424.37	$391.43	69.18%
Aetna Open Access - New Jersey [Basic Also, But Considered Standard]	$832.11	$391.43	$624.08	$391.43	47.04%

UNITED STATES POSTAL SERVICE

Appendix B: USPS Health Plans

The chart below provides descriptions for the health plan features included in the modeled USPS health plans.

HayGroup®

	High Option		Middle Option		Value Option	
	In Network	Out of Network	In Network	Out of Network	In Network	Out of Network
Dependent Age	To Age 26	To Age 26	To Age 26	To Age 26	To Age 26	To Age 26
Annual Deductible						
Single	$250	$500	$500	$1,000	$2,000	$4,000
Family	$500	$1,000	$1,000	$2,000	$4,000	$8,000
Does the deductible count towards the OOP maximum?	No	No	No	No	No	No
Annual Out of Pocket Maximum						
Single	$3,000	$6,000	$4,000	$8,000	$6,000	$12,000
Family	$6,000	$12,000	$8,000	$16,000	$12,000	$24,000
Network Sharing Does the deductible and the OOP cross apply to In-Network and Out-of-Network ?	No	No	No	No	No	No
Annual Out of Pocket Maximum (Mental Health & Sub Abuse)						
Single	$3,000	$6,000	$4,000	$8,000	$6,000	$12,000
Family	$6,000	$12,000	$8,000	$16,000	$12,000	$24,000
Inpatient Hospital	Preauthorization Required	Preauthorization Required	Preauthorization Required	Preauthorization Required	Preauthorization Required	Preauthorization Required
Room and Board	90%	60%	85%	50%	75%	50%

HayGroup®

	High Option		Middle Option		Value Option	
	In Network	Out of Network	In Network	Out of Network	In Network	Out of Network
Other inpatient expenses	90%	60%	85%	50%	75%	50%
Transplants	90%	60%	85%	50%	75%	50%
Inpatient Hospital Mental Health	Preauthorization Required	Preauthorization Required	Preauthorization Required	Preauthorization Required	Preauthorization Required	Preauthorization Required
Room and Board	90%	60%	85%	50%	75%	50%
Other inpatient expenses	90%	60%	85%	50%	75%	50%
Inpatient Hospital Substance Abuse	Preauthorization Required	Preauthorization Required	Preauthorization Required	Preauthorization Required	Preauthorization Required	Preauthorization Required
Room and Board	90%	60%	85%	50%	75%	50%
Other inpatient expenses	90%	60%	85%	50%	75%	50%
Skilled Nursing/Extended Care Facility (coordinates w/ Medicare)	90%	60%	85%	50%	75%	50%
Outpatient Hospital	24 hour nurse line	24 hour nurse line	24 hour nurse line	24 hour nurse line	24 hour nurse line	24 hour nurse line
Emergency room for medical emergency	90%	90%	85%	85%	75%	75%
Emergency room for accidental injury (within 72 hours)	90%	90%	85%	85%	75%	75%
Outpatient Surgery	90%	60%	85%	50%	75%	50%
Outpatient Laboratory	90%	60%	85%	50%	75%	50%
Outpatient Radiology	90%	60%	85%	50%	75%	50%
Physician Services	90%	60%	85%	50%	75%	50%

HayGroup®

	High Option		Middle Option		Value Option	
	In Network	Out of Network	In Network	Out of Network	In Network	Out of Network
Inpatient Surgery	90%	60%	85%	50%	75%	50%
Outpatient Surgery	90%	60%	85%	50%	75%	50%
Maternity	90%	60%	85%	50%	75%	50%
Routine Primary Care Office Visits-Adults	100%	100%	100%	100%	100%	100%
Routine Primary Care Office Visits-Well Child Care	100%	100%	100%	100%	100%	100%
Other Primary Care Visits (sickness)	$25 copay	60%	$35 copay	50%	$50 copay	50%
Specialist Office Visits	$40 copay	60%	$50 copay	50%	$70 copay	50%
Inpatient Visits	90%	60%	85%	50%	75%	50%
Outpatient Mental Health Visits	$40 copay	60%	$50 copay	50%	$70 copay	50%
Outpatient Radiology (doctor's office or independent facility)	90%	60%	85%	50%	75%	50%
Outpatient Laboratory (doctor's office or independent facility)	90%	60%	85%	50%	75%	50%
Allergy or hormone injections by nurse in physician's office	90%	60%	85%	50%	75%	50%
Immunization (Childhood)	Covered at 100%	Covered at 100%	Covered at 100%	Covered at 100%	Covered at 100%	Covered at 100%

HayGroup®

	High Option		Middle Option		Value Option	
	In Network	Out of Network	In Network	Out of Network	In Network	Out of Network
Routine Immunizations	Covered at 100%	Covered at 100%	Covered at 100%	Covered at 100%	Covered at 100%	Covered at 100%
Physical Therapy (combined physical, speech and occupational therapy)	90% limited to 60 visits per cal year	60% limited to 60 visits per cal year	85% limited to 60 visits per cal year	50% limited to 60 visits per cal year	75% limited to 60 visits per cal year	50% limited to 60 visits per cal year
Home Health Care	90%	60%	85%	50%	75%	50%
Durable Medical Expenses	90%	60%	85%	50%	75%	50%
Chiropractic Treatment (12 visits/manipulations per yr)	$25 copay	60%	$25 copay	50%	$25 copay	50%
Eye Wear	Not covered	Not covered	Not covered	Not covered	Not covered	Not covered
Hearing Aids	100% up to $1,500 (no deductible)	100% up to $1,500 (no deductible)	100% up to $1,500 (no deductible)	100% up to $1,500 (no deductible)	100% up to $1,500 (no deductible)	100% up to $1,500 (no deductible)
Optometry Exams	90% (1 screening for child covered at 100%)	60% (children: 100% up to $250/child)	85% (1 screening for child covered at 100%)	50% (children: 100% up to $250/child)	75% (1 screening for child covered at 100%)	50% (children: 100% up to $250/child)
Hearing Exams	90%	60%	85%	50%	75%	50%
Prescription Drug	Prior authorization required for certain specialty drugs		Prior authorization required for certain specialty drugs		Prior authorization required for certain specialty drugs	
Retail	10% for Generics 20% for Formulary Brand 40% for Brand & Specialty		10% for Generics 20% for Formulary Brand 40% for Brand & Specialty		10% for Generics 20% for Formulary Brand 40% for Brand & Specialty	
Annual Rx OOP limit	$1,500		$1,500		$1,500	

Appendix C: Actuarial Certification

The United States Postal Service retained Hay Group to prepare estimates of the retiree medical benefit obligations under a range of proposals for a USPS Health Plan.

These estimates have been prepared in accordance with generally accepted actuarial principles and practices.

The results shown in this report are reasonable actuarial results. However, a different set of results could also be considered reasonable actuarial results. Thus, reasonable results differing from those presented in this report could have been developed by selecting different points for various assumptions.

The actuaries certifying to these estimates are members of the Society of Actuaries and other professional actuarial organizations, and meet the General Qualification Standards of the American Academy of Actuaries for purposes of issuing Statements of Actuarial Opinion.

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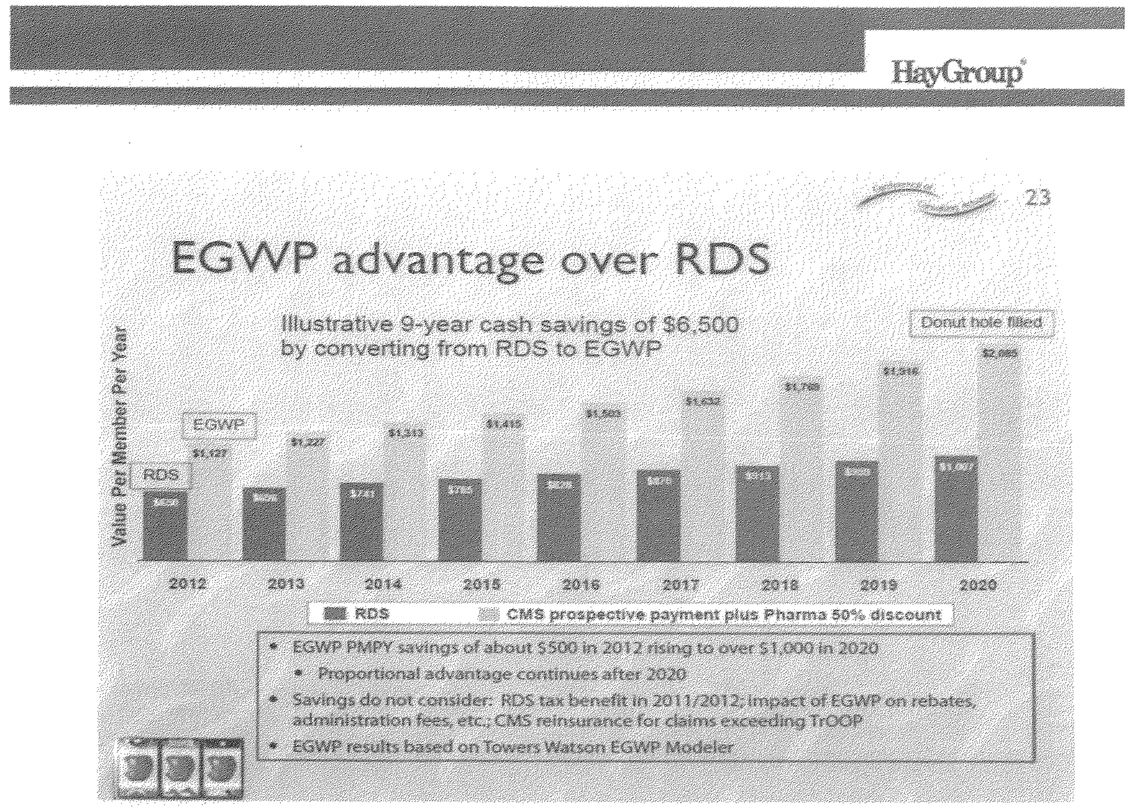
Appendix D: EGWP Expected Value

The chart below was presented at the 2011 Conference of Consulting Actuaries Annual Meeting in Session 38: ***Reform Reshapes the Retiree Medical Environment*** by Barry Carleton, Senior Consultant at Towers Watson.

The chart shows the expected value of the Employer Group Waiver Plan, including the 50% Pharma discount is $1,227 in 2013.


HayGroup
23
EGWP advantage over RDS
Illustrative 9-year cash savings of $6,500
by converting from RDS to EGWP
Donut hole filled
Value Per Member Per Year
EGWP
RDS
$1,127
$1,227
$1,313
$1,415
$1,503
$1,632
$1,768
$1,916
$2,085
$741
$785
$828
$870
$913
$960
$1,007
2012
2013
2014
2015
2016
2017
2018
2019
2020
RDS
CMS prospective payment plus Pharma 50% discount
• EGWP PMPY savings of about $500 in 2012 rising to over $1,000 in 2020
• Proportional advantage continues after 2020
• Savings do not consider: RDS tax benefit in 2011/2012; impact of EGWP on rebates, administration fees, etc.; CMS reinsurance for claims exceeding TrOOP
• EGWP results based on Towers Watson EGWP Modeler

Questions for Patrick R. Donahoe
Postmaster General/CEO
United States Postal Service

Chairman Darrell Issa
Committee on Oversight and Government Reform
Subcommittee on Federal Workforce, U.S. Postal Service and Labor Policy

Hearing on, "Can a USPS-run Health Plan Solve its Financial Crisis?"

"Plan to Profitability" Business Plan

1. The 5-Year Business Plan calls for $4.1 billion in annual savings from consolidating mail processing and related transportation — a significantly larger target than the $2.5 billion in estimated annual savings from closing or consolidating 223 mail processing facilities. How does USPS plan to save the full $4.1 billion? How much of these savings come from closing and consolidating mail processing facilities, and how much is attributable to other actions?

The $4.1 billion includes the Network Rationalization consolidation initiative filed with the Postal Regulatory Commission (PRC) as well as the expected workload reduction (>$1.5B) that is tied to our projected volume declines. Each year we set goals for efficiency targets –as volume declines we challenge our managers to reduce workhours (resulting in a reduction in compensation and benefits expense) in amounts that will maintain or improve our efficiency. This is the method by which we have eliminated more than 21% of workhours over the last 5 years. While the ability to extract hours in our current network configuration is becoming more difficult each year, we have set the bar high and expect our managers to meet the new targets.

There are two components to the network savings, as well as the other cost-saving initiatives: 1) savings resulting from proactive efforts to restructure postal operations, and 2) savings occurring as a result of proactively reducing workhours and other costs as a result of reduced mail volume. Combined, these two categories are expected to yield savings of $4.1 billion in 2016. By 2016, the estimated savings from network optimization (including closing/consolidating mail processing facilities) will be $2.5 billion and we expect to realize approximately $1.6 billion of savings as a result of reducing workhours and other expenses in concert with declining mail volume.

2. The 5-Year Plan calls for $2 billion in annual savings from reducing post office costs - a target that dwarfs the potential savings of $200 million from USPS's initiative to close thousands of small post offices in rural areas. How does USPS plan to achieve $2 billion in retail savings by 2016? Will USPS continue to target small rural post offices for a disproportionate share of its cost-cutting efforts?

The Postal Service never targeted small rural post offices for a disproportionate share of cost-cutting. Rather, we used an empirically-based methodology to identify Post Offices to be studied for possible discontinuance. Once included among potential closures, local management has a prescribed course of action, following postal regulations and Federal law that involve notifications, community meetings/input, and a localized study of the proposed closures impact. The process can and does result in offices being taken off the list.

The $2 billion in annual savings includes several key retail related initiatives, including post office discontinuances, as well as $1.4 billion in expected workload loss, due to the

projected volume decline.

In managing the retail network, the Postal Service has three key areas of focus. The first is to reduce our retail costs through increased use of self-service. Currently, only 7% of Post Offices have self-service that enables customers to purchase stamps and pay for postage to mail letters and ship packages. To achieve cost savings while improving customer experience, the Postal Service will increase deployment and customer adoption of self-service in its highest traffic Post Offices. The second emphasis is to better leverage retail partners to continue to provide customers with various access options to postal services. The third area of focus is to drive more adoption of *usps.com*, mobile, and third party online partners, while continuing to improve the digital experience and enhance the ability to transact and purchase postal services online.

Beyond the changes in the retail structuring and utilization of alternate access points, the Postal Service is going to have an increased focus on the non-career Postal Support Employee (PSE) hiring provision agreed to in the current Collective Bargaining Agreement (CBA) established with the American Postal Worker's Union (APWU). The PSE is a non-career employee that is allowed to be trained in specific skill sets with greatly reduced labor costs to the Postal Service. The current CBA allows the Postal Service the right to hire PSEs up to 20% of the total Function 4 workforce. The provision also allows the Postal Service to hire PSEs above that cap to fill any position identified as "new work". There will also be a continued focus on managing operational work hours to the actual work load, which will also result in reduced operating expenses as well.

3. The 5-Year Plan calls for $3 billion in annual delivery savings apart from the $2 7 billion in savings USPS projects it would achieve from 5-day delivery. Where will the $3 billion in additional savings come from?

The majority of the estimated delivery savings (approximately $2 billion) are from proactive reductions in workhours resulting from forecasted mail volume declines. The remaining $1 billion of savings is attributed to several key operational strategies.

The Postal Service is utilizing a standardized program, called Delivery Unit Optimization (DUO) to increase operational efficiencies by relocating delivery operations to "hub facilities" within a district. By relocating the delivery operations of smaller delivery units to a typically larger office within 10 miles of the unit, transportation and operational costs can be significantly reduced. The savings are attributed to streamlining delivery unit clerical and postmaster operations, economy of scale staffing improvements, and reductions in facility space.

We have recently made changes to the regulation of mode of delivery for any new growth in residential delivery points (not existing delivery points) in order to ensure the most efficient and cost-effective methods are used. This effort represents a change to delivery operations regulations and fundamentally changes the street delivery infrastructure for new delivery. The changes target regulations in the Postal Operations Manual (POM) that allow for various modes of delivery for new or fill-in construction deliveries. The Postal Service will now be the final determinant in the appropriate mode of delivery to provide adequate and necessary service when new delivery is established or extended. The savings will be derived from reducing a portion of the curb-line deliveries added each year.

We also are taking steps to change existing modes of delivery for business into the most efficient modes possible. We plan to convert substantial portions of the current 5.5 million business "other" deliveries to centralized delivery. This will be done by regulatory change granting the Postal Service the authority to control its mode of delivery for both new and existing delivery locations.

4. Many aspects of the 5-Year Plan are at least somewhat dependent on the cooperation of the postal unions Have the unions or management associations endorsed any cost reduction efforts in this plan? Have the unions or management associations brought forward any ideas that could save or generate at least $100 million per year?

The contract with the APWU contained many breakthrough provisions critical to the Postal Service's ability to control labor costs. This includes a two-year wage freeze, a dramatic increase in the allowable number of lower-cost and more flexible non-career employees, a two-tier wage structure, more flexibility in scheduling and a reduction in the employer's contribution to health benefit premiums. These changes will save significantly in excess of $100 million annually. Indeed, when compared to the previous contract, the new contract was initially estimated to save the Postal Service $3.8 billion over its term, based on the complement and attrition projections at the time.

The unions have not endorsed the network realignment initiative or the proposal to reduce the number of delivery days. In negotiations and subsequent dispute resolution proceedings with the other unions and in consultation proceedings with the management associations, proposals that will save amounts far in excess of $100 million are very much part of the discussion, but those proceedings have not yet concluded.

USPS Proposal for Its Own Health Plan (USPS health care proposal)

5. List all the specific legislative changes needed before USPS can withdraw from the Federal Employees Health Benefits Program (FEHBP) and implement its own health care plan.

The FEHBP statute (chapter 89 of title 5, United States Code) provides that Postal Service annuitants are covered by FEHBP. Current employees, on the other hand, are covered by FEHBP by operation of 39 U.S.C. § 1005(f), which provides that employees shall be covered by FEHBP unless such coverage is "varied, added to, or substituted for" after adherence to the Postal Service's collective bargaining and consultation requirements. This provision allows the Postal Service to withdraw non-bargaining unit employees from FEHBP without a legislative change, so long as we engage in the required consultations with the management associations. Bargaining unit employees can be also be withdrawn from FEHBP, but only pursuant to the terms of a collective bargaining agreement.

Legislative change to chapter 89 of title 5 is therefore needed to provide that Postal Service annuitants are not eligible for coverage under FEHBP upon the effective date of the Postal Service plan. In addition, to allow the Postal Service to establish a new plan without securing the agreement of its unions, section 1005(f) of title 39 needs to be revised to eliminate the reference to chapter 89. Rather, a new section of title 39 would be added that provides that officers and employees are no longer eligible for coverage under FEHBP upon the effective date of the Postal Service plan. This new section would also authorize the Postal Service to establish a health plan for its officers, employees, and annuitants, without undertaking collective bargaining. The Postal Service would

have the authority to design the plan benefits, while the level of Postal Service contributions would remain subject to collective bargaining. It should also be provided that the Postal Service shall not be subject to suit or liability as a result of such elimination of FEHBP coverage.

As part of separating the Postal Service from FEHBP, certain provisions of chapter 89 governing contributions for annuitant health benefits would need to be revised. Specifically, section 8906(g)(2)(A) of title 5 needs to be revised to provide that no further contributions would be required from the Postal Service or the Postal Service Retiree Health Benefits Fund (PSRHBF) to FEHBP for annuitant coverage once the Postal Service plan is established. Furthermore, the legislation would need to provide that the Treasury continues to pay a prorated amount for the health benefits of annuitants who worked for the Government (including the Post Office Department) prior to the establishment of the Postal Service (see 5 U.S.C. § 8906(g)(2)(B)). This amount would be paid to the new Postal Service plan. Furthermore, the legislation should amend 5 U.S.C. § 8909 to transfer to the new Postal Service plan the portion of any FEHBP contingency reserves held by OPM that are allocable to contributions previously made by the Postal Service and its employees/annuitants.

In addition, the legislation would need to amend 5 U.S.C. § 8909a, which governs the PSRHBF. Because the Postal Service would be assuming the health care liability for annuitants, it would need access to the assets in the PSRHBF. There are a few options the Congress could choose from. First, legislation could return the PSRHBF to a trust the Postal Service could establish. Another method would be to retain the PSRHBF, but amend the statute to allow the assets in that Fund to be used to pay the Postal Service's contribution to annuitant health coverage under the new Postal Service plan. The legislation could also continue to require that the Postal Service prefund retiree health benefits, but on an actuarial basis (i.e., the payment of Normal Cost plus an amortization payment for the unfunded liability) rather than under the current prefunding schedule. The legislation should also require that in calculating the unfunded liability, funding assumptions consistent with the calculation of the Postal Service's pension liabilities should be used, rather than the accounting assumptions that are currently used.

Another option would be to retain the PSRHBF only for use in paying the Postal Service's contribution for the health care benefits of annuitants who have already retired or who retire before the effective date of the new plan. The legislation could then authorize the Postal Service to establish a trust fund, into which the Postal Service would make prefunding payments on an actuarial basis. The legislation should provide that assets in the PSRHBF that are not necessary to pay benefits for current annuitants would be transferred to the new trust fund.

A critical aspect of the Postal Service plan is coordinating with Medicare Parts A, B, and D in a manner consistent with best practices in the private sector. The plan design would incentivize annuitants to enroll in Parts A and B once they become eligible. Because a proportion of Medicare-eligible annuitants have not enrolled despite their eligibility, legislation is needed that would provide special enrollment periods for those annuitants. Furthermore, the legislation should also waive the Medicare late enrollment penalty for those annuitants. Regarding Part D, the Postal Service will provide prescription drug benefits through an Employer Group Waiver Plan.

6. Does USPS propose funding retiree health care through a trust fund, and if so, how would USPS run

the fund? Would USPS merge the Retiree Health Benefits (RHB) Fund into this trust fund, and if so, when? If not, when does USPS plan to draw on the RHB Fund?

In response to questions raised by various members of Congress and other stakeholders, the Postal Service has proposed two potential approaches to funding, as follows:

1. **USPS would continue to make future contributions to the existing Postal Service Retiree Health Benefits Fund (PSRHBF), to fund future liabilities and amortize any remaining unfunded liability; or**
2. **USPS would create a new Voluntary Employees' Beneficiary Association (VEBA) trust fund that would be the receptacle for future contributions on behalf of current active employees. To the extent that the assets in the current PSRHBF were in excess of the funds required to fully cover the liability for current annuitants and their dependents, those excess assets would be deposited directly to the new fund.**

Either approach would be satisfactory from the perspective of the Postal Service. In either approach, however, the assets of the PSRHBF or the VEBA trust would be used to pay the claims and expenses (i.e. the premiums) associated with the costs for the annuitants and dependents who are the beneficiaries of either the PSRHBF or both funds in the event a separate fund is established.

7. More than 200 plans participate in the FEHBP, and enrollees can choose from a minimum of 13 nationwide products offered by six different insurance carriers at a uniform premium. Local plan options are also available. Would a USPS health plan with fewer choices offer the same level of care and coverage as the FEHBP, especially in rural areas? How?

The Postal Service is committed to providing a choice of health plans to employees and retirees – with benefit levels comparable to the FEHBP plans with the highest enrollment. The USPS "High" plan will provide more financial protection than the BCBS Standard plan and the USPS "Middle" plan will provide more financial protection than the BCBS Basic plan. USPS will also sponsor a "Value" plan to offer employees a lower premium option that still provides adequate financial protection – and at the same time meet the requirements of the *Patient Protection and Affordable Care Act* for certain non-career employees who will work more than 30 hours per week in 2014. While it is true that FEHBP offers a minimum of 13 nationwide products, when these choices were analyzed by USPS it was determined that there was very little difference in plan designs and overall plan value between most of these options.

USPS is confident that a USPS health plan will provide excellent provider network coverage in rural areas comparable to FEHBP. In December 2011, USPS conducted market research with many large medical and pharmacy benefit managers, including Blue Cross and Blue Shield, Aetna, CIGNA, United Healthcare, Medco, Express Scripts Inc, and CVS/Caremark. All of these vendors also participate in FEHB. One of the key areas of research was the availability of medical provider networks in all locations where USPS has employees and retirees. Listed below are the results of the network provider access research using geo-access technology and standard industry criteria.

Location	Hospital Standard	Vendor 1	Vendor 2	Vendor 3	Vendor 4
Urban	1 hospital within 5 miles	96.9%	93.1%	96.2%	93.5%
Suburban	1 hospital within 10 miles	98.3%	97.6%	98.2%	97.0%
Rural	1 hospital within 20 miles	89.2%	85.1%	89.0%	84.2%

Location	Primary Care Physician Standard	Vendor 1	Vendor 2	Vendor 3	Vendor 4
Urban	2 providers within 5 miles	98.8%	99.8%	98.6%	98.7%
Suburban	2 providers within 8 miles	99.2%	99.7%	99.2%	98.9%
Rural	2 providers within 20 miles	94.5%	93.8%	94.2%	93.4%

Location	Specialist Physician Standard	Vendor 1	Vendor 2	Vendor 3	Vendor 4
Urban	2 providers within 5 miles	98.9%	99.5%	98.6%	99.2%
Suburban	2 providers within 8 miles	99.3%	99.4%	99.2%	99.1%
Rural	2 providers within 20 miles	95.1%	88.3%	94.4%	93.0%

While there are challenges in rural areas, regardless of whether benefits are provided through FEHB or a separate USPS plan, USPS has sufficient scale and purchasing power to assure that those challenges are met, and the marketplace will be responsive to our requirements in that area.

8. USPS covers approximately 80 percent of the cost of employee FEHBP premiums, compared to 72 percent for other federal agencies. Under the USPS health care proposal, what share of the premium cost would USPS cover? Specify the current and proposed percentage for each of the following. executives, non-bargaining employees, and employees covered by each collective bargaining agreement.

The current contribution formula for non-Postal Federal employees and for all annuitants is as follows:

1. **The first limiting factor is that the employer contribution cannot exceed 72% of the so-called "weighted average premium." That weighted average premium is the average weighted by participant counts (Federal and USPS employees and retirees and survivors) among all plans included in the FEHBP program for the preceding year. The current (2012) year's dollar limit is $185.75 bi-weekly for self only coverage, for example. (That is the maximum employer contribution to any particular plan for self only coverage).**

2. **The second limiting factor is that the employer contribution cannot exceed 75% of the cost of a particular plan.**

That results in an overall average employer contribution for non-Postal Federal employees and annuitants of approximately 70% of premiums; the employee contributions are approximately 30% of premiums. However, the actual contribution to the cost of particular plans varies widely.

There is a leveraging factor in the determination of contributions for high cost plans. That is because once a plan's cost exceeds the weighted average premium, 100% of the additional cost over that threshold is absorbed by the participant.

The result, generally, is that high cost plans cost the participant more than 30% of premiums, with some plans costing the participant 40% contributions or more; moderate cost plans cost about 27% of premiums; and low cost plans will generally cost the employee the minimum cost of 25% of premiums.

The allocation of costs between employer and employee contributions is the subject of collective bargaining between the Postal Service and the bargaining groups, and a change in the allocation is subject to consultation with the non-bargaining employees who are represented by the management associations.

The allocation for the bargaining groups can only be changed by agreement of the parties, or by the award of an arbitration panel in interest arbitration. While the Postal Service has been successful in moving the contributions more closely toward the Federal contribution standard since the Valtin arbitration in 1994, there remains a fairly large gap, as your question indicates.

The question correctly observes that the current USPS contributions result in an average contribution of roughly 80%/20%. Below is a complete chart reflecting the current contribution formulas in place under bargaining agreements and/or arbitration awards, and the agreements in place with the non-bargaining represented employees. The chart also reflects where the current contributions are being changed in future years subject to the terms of those agreements or awards.

Employee Group	**2012**	**2013**	**2014**	**2015**	**2016**
APWU	81%/84.5%	79%/82.25%	78%/81.25%	77%/80.25%	76%/79.25%
NALC	80%/83 5%	Subject to bargaining.	Subject to bargaining.	Subject to bargaining	Subject to bargaining.
Mail Handlers	80%/83.5%	Subject to bargaining	Subject to bargaining	Subject to bargaining.	Subject to bargaining.
Rural Carriers	81%/84 5%	Subject to bargaining.	Subject to bargaining.	Subject to bargaining.	Subject to bargaining.

EAS	81%/84.5%	Subject to consultation.	Subject to consultation.	Subject to consultation.	Subject to consultation.
PCES	91%/94.75%	82% proposed	72% proposed	72% proposed	72% proposed
The first number is the percent of the federal weighted average formula The second number is the limit upon the contribution to any plan					

USPS has proposed in the current negotiations with the NALC and the Mail Handlers unions that the Postal Service contribution move to an amount that is equivalent to the Federal formula. That is also our proposal to the arbitration panel currently considering the issues involved in our interest arbitration with the National Rural Letter Carriers Association. Ultimately, the former will be decided through negotiations if the parties can reach agreement. The latter will be decided by the arbitration panel under Chair Jack Clark.

Until 2011, the Postal Service paid the entire premium for executives and their eligible dependents. However, in an announcement to our executive staff in 2010, we advised those participants that we would be phasing in over three years beginning in 2012, a contribution by participants that will reach a contribution equal to or equivalent to the Federal FEHBP formula.

In the proposals to the unions and in our plans for executive staff, we have made it clear that our goal is to reach the approximately 70%/30% employer/employee allocation that pertains now in the FEHBP formula.

9. Walton Francis's testimony stated that the "USPS proposals would massively disrupt or destroy the FEHBP, the single most successful health insurance program ever operated by the United States government. In destroying the FEHBP, the USPS would disrupt the health insurance of 8 million Americans, and breach statutory entitlement promises made to millions of Federal retirees." He estimated that the total number of national plans would drop from 18 to 11. How would USPS's withdrawal from FEHBP impact the program and the remaining federal employees and retirees? How many will have to change health plans and find new doctors?

We would not expect any significant disruption in the FEHBP program. It is hard to follow the logic which underlies Mr. Francis' contention that OPM is efficiently managing a program that currently provides some 200 plan options to approximately 9 million participants, but that OPM will be unable to manage with comparable efficiency a program that will retain approximately 200 plan options and some 7 million participants, if the USPS establishes its own plan. It is of course impossible to predict with any certainty that the number of national plans would drop from 18 to 11 and there is no reason to conclude that any of these major plans would choose to exit the system.

The responses in our meetings with the major health care vendors (as part of our market research conducted by our Supply Management group) and the responses of those vendors to the written questionnaires we provided them illuminated the fact that the marketplace is actively interested in partnering with USPS in a new plan that will incorporate the best practices that they pursue in providing health care services not only within FEHBP, but also with their large private sector and state and local government customers.

We expected that result, and we fully expect that these same vendors (all of whom have relationships now with various FEHBP plans) will continue to be equally interested in serving a population that, in total, will remain some 3 times as large as the USPS population standing alone.

All these competitors in the health care field depend on scale in their business. That scale is essential both to operate the plans they serve efficiently but also—and more importantly in terms of their competitiveness in this marketplace—to use the leverage that scale creates to negotiate the most favorable commercial arrangements available from health care providers, including network discounts and pharmacy pricing.

Far from "destroying" FEHBP, a new USPS-sponsored plan would solve some of the problems with that system which Mr. Francis has identified. This plan actually has the potential to improve that system, by providing examples of how to adopt private sector and state and local government best practices and how to resolve some of the major problems that Mr. Francis has described in testimony before the Congress and in other forums.

In a presentation delivered in November 2011 to the American Enterprise Institute, Mr. Francis identified several of what he described as "Big Flaws" in the FEHBP system. Just to cite two examples from his presentation:

- It has NO risk adjustment mechanism of any kind, which leads to risk segmentation and distorts consumer choices.
- It has never been modified to adjust to the existence of Medicare, even though Federal retirees now get Medicare.

As we have discussed with the various stakeholders with whom we have met—including congressional staffs, administration officials, union and management association leadership—both of these issues are fully addressed in the USPS proposal in ways that will provide great benefit to USPS and to participants, through their lower premium contributions.

USPS is projecting total cash savings in the first year (if our proposal is adopted) of $1.755 billion, ignoring the impact on retiree health care liability and the remaining scheduled payments under the *Postal Accountability and Enhancement Act (PAEA)*. That cash savings will be shared with participants through lower premiums and their share of the savings is projected to be $653 million, or about $700 annually per participant.

The first of those flaws identified by Mr. Francis is addressed through the restoration of a direct relationship between the value of a plan's benefits and the cost of the plan at the participant level—a relationship which simply does not now exist within FEHBP. The second flaw is addressed through our proposals for current and future annuitants, to take full advantage of the coverage available to eligible participants through participation in Medicare Parts A and B, and the wrap-around plan for prescription drugs, which will take full advantage of the savings available under Medicare Part D.

It is possible that there would be a few plans that would no longer be available or that might choose to exit the system. For example, the plan sponsored by the National Rural

Letter Carriers Association (NRLCA) is a closed plan, open only to members of NRLCA. But those members would be well-served by the new USPS plan.

It is also possible that some smaller plans might choose to exit the system. There is no possibility that plans serving any significant segment of the non-Postal participant population under FEHBP would elect to exit the system, in a competitive environment where scale is and will continue to be a major factor in determining market share and competitive advantage in a segment of the U.S. economy that accounts for more than a sixth of the total Gross Domestic Product (GDP).

Even if some plans exit the system, the disruption in terms of availability of doctors should be minimal. The participants are already in a doctor/patient relationship. And the overlap of doctors among major health care vendors in particular markets is very substantial. In private sector plans (and in state and local government plans) that are competitively bidding health benefit arrangements, the plan sponsor uses data driven techniques to identify and manage the extent of any disruption that might occur, and those techniques will be applied in the Supply Management process that will guide USPS procurement efforts.

10. Under the USPS health care proposal, how much will USPS save annually by shifting costs to Medicare, through the Employer Group Waiver Program tied to Medicare Part D? How much will USPS cost shifting to Medicare increase the unfunded liability of the Medicare trust fund on an annual basis?

The USPS health care proposal to include an Employer Group Waiver Plan (EGWP) is expected to save $539 million in 2013. Of this, $166 million would come from the Pharmaceutical Manufacturers payment of 50 percent of Brand drug costs for retirees with drug expenditures in excess of the Initial Coverage Limit. The balance of $373 million would come from the Medicare Part D program—increasing the Part D program costs from $85.2 billion to $85.6 billion.

The 2011 Medicare Trustees Report projects the 2013 cost for Part A as $287.7 billion[1] and the cost for Part B as $233.7 billion[2] for a total of $521.4 billion. If all USPS retirees who are eligible for Medicare and not currently enrolled in Medicare Parts A and B were to enroll, the 2013 expenditures would increase by $0.6 billion to $522 billion. This is an increase of 0.1%.

11. USPS proposes to freeze the dollar amount that it pays towards the employer share of premiums at the level it is at when the employee retires. This would force postal retirees on fixed income to bear the full brunt of premium increases. Would the exponentially increasing cost for premiums eventually price out long-lived retirees from health coverage? Using current medical inflation estimates, how many years would the average postal retiree have to live before retiree health care premiums cost for the individual and a spouse reach 40% of the average pension?

Freezing the dollar amount of the employer subsidy is not currently a part of the USPS health plan proposal.

12. According to Walton Francis's testimony, postal employees would be more expensive to insure than

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[1] See Table III.B4

[2] See Table III.C8

non-postal federal employees because postal employees comprise a risk pool that is significantly older than that of the FEHBP as a whole. He stated that "to provide the identical benefits and premium levels to USPS employees that non-postal employees receive will cost about one sixth more per employee or about one tenth of the all-employee average." Thus, "the cost of a pullout to the USPS will exceed one billion dollars annually to maintain current levels of benefits and premiums."

a. Is USPS's employee population more or less expensive to insure than non-postal FEHBP enrollees? How much more or less expensive? Provide support.

b. If USPS estimates its population is less expensive (in part a. above), would a USPS withdrawal from FEHBP result in higher premiums for remaining non-postal employees?

c How has USPS's hiring freeze affected its employee demographics in terms of cost to insure?

USPS does not have access to the health insurance costs for either Postal or non-Postal participants in FEHBP. Therefore, it is not known if postal employees cost more to insure than non-postal employees. The USPS employee population is a few years older, on average, than the non-postal population, while the annuitant population is a little younger on average than the non-postal annuitant population. However, given the physical nature of most Postal employees' jobs (including a considerable amount of daily walking), their health status may be better and therefore offset some or all of the expected higher costs from the demographic differences. The hiring freeze has resulted in a slight aging to the postal active workforce; however, the cost to insure is based on the overall FEHBP population.

13. FEHBP annual premium increases have been at or below the private sector. What, if any, assurances can USPS provide that it will be able to achieve similar cost containment - particularly in light of the even lower health insurance premiums USPS employees currently enjoy and USPS's stated belief that the current collective bargaining process is biased against USPS?

The new USPS health plan will contain many elements that will assist in managing the underlying health care trend experienced by all health plans. The major components of the health care trend include: increases in the unit cost of services, increases in the number of services used per member, and advances in medical technology.

To assist in managing the unit cost trend, the USPS health plan will contract with a large third-party provider network which uses its combined membership to negotiate the best discounts and control price increases with medical providers. As part of the procurement process, USPS will evaluate the network on its ability to offer competitive unit prices for medical services.

The new USPS Health plan will also include many elements that have been proven to help moderate medical trend. These include:

- **Wellness and disease management programs targeted to the USPS population.**
- **A focus on health improvement using health assessments and health coaching.**
- **High performance networks that focus on both cost and quality outcomes.**
- **Use of gaps in care technology and opportunities for health improvement.**
- **Inclusion of centers of excellence for complex medical conditions.**
- **Pharmacy management programs that promote the use of generics and mail order.**

14. In his testimony, Walton Francis opposed USPS's plan to offer a "self and spouse" option because

enrollees would be more expensive to insure than those in a "family option." The USPS health care proposal plans to charge a lower premium for "self and spouse" than the more expensive "family option." Why does USPS believe that those employees who would enroll in a "self and spouse" option are cheaper to insure than a "family option?" Provide support, including key underlying assumptions.

The Self & Spouse option would cover two adults, whereas the Family option would cover two adults plus one or more children. As the Family option would cover more lives, its cost would be higher. (Note that if an insurer offered a "family" option at a lower price than the "self & spouse" option, couples would enroll in the family option to save money).

The assumptions that were used in developing the costs for the four tiers were:

- **Self & Spouse cost is expected to be 208% of the Self cost**
- **Employee & Child(ren) cost is expected to be 169% of the Self cost**
- **Family cost is expected to be 274% of the Self cost**

15. USPS has projected its health care proposal will reduce its unfunded liability for retiree health benefits. Provide breakdowns of each plan element that would reduce this liability and how much the element would reduce the liability.

In their February 10, 2012 report, HayGroup provided a breakdown in Table 1, on page 3, of each element of the Postal health plan that would reduce the liability. A copy of the report is attached.

Table 1 - USPS Retiree Health Benefits Elements
Funding Assumptions
Assumes Accelerated Retirements
(Amounts in $millions)

Scenario	Assumptions	2013 Liability	2013 Assets	2013 Unfunded Liability	2013 Funding
Current Law	Accounting Liability Continued participation in FEHBP and declining workforce. No additional prefunding payments in 2011, 2012, 2013	$102,291	$48,963	$53,328	$8,699
	Change from Federal accounting standards to OPM OOA funding assumptions	$91,040	$48,963	$42,077	$8,699
USPS Health Plan in 2013 (Element 1)	Non Medicare Annuitants and Survivors assumed to enroll in Medicare A and B with no penalty	$74,830	$48,963	$25,867	$4,112

Table 1 - USPS Retiree Health Benefits Elements Funding Assumptions Assumes Accelerated Retirements (Amounts in $millions)					
Scenario	Assumptions	2013 Liability	2013 Assets	2013 Unfunded Liability	2013 Funding
USPS Health Plan in 2013 (Element 2)	Includes Element 1, and additional savings arising from EGWP + Wrap plan for Post- 65 Enrollees.	$53,903	$48,963	$4,940	$2,191
USPS Health Plan in 2013 (Element 3)	Includes Element 2, and revised four tier retiree contributions	$59,434	$48,963	$10,471	$2,719
USPS Health Plan in 2013 (Element 4)	Includes Element 3, and additional savings of 8 percent for Pre-65 retirees from Purchasing	$57,538	$48,963	$8,575	$2,526
USPS Health Plan in 2013 (Element 5)	Includes Element 4, and savings due to Future Retirees having Carve-out.	$50,385	$48,963	$1,422	$1,753

16. Will the USPS health plan proposal allow postal employees to select health plan types currently available to them through FEHBP, such as the APWU consumer driven health plan? Why or why not?

Initially, the new USPS health plan will have a choice of three PPO options and a staff/group model HMO choice in locations where large numbers of USPS employees currently select an HMO option. These are the same types of plans as offered in FEHBP. One of the goals of the USPS health plan is to simplify the choices available so that participants can make informed decisions about selecting a health plan option. USPS would definitely consider adding a consumer-driven or high deductible option as an additional choice.

17. FEHBP is often cited as the gold standard for health insurance coverage by members of Congress, and President Obama promoted it as a model for health reform. What specific inefficiencies in FEHBP lead USPS to believe that it can run a health insurance program more effectively?

While there is much to commend in FEHBP, Mr. Francis and others have also been candid about flaws in the system. We agree with Mr. Francis that the failure to integrate the FEHBP plans with Medicare is among those major flaws. Medicare was signed into law by President Lyndon B. Johnson in July 1965. While in the early years relatively few annuitants had Medicare (they did not qualify unless they earned enough quarters outside Federal employment), Federal employees (including USPS employees) have been in the Medicare system since 1984. Yet nothing has been changed over this period to integrate the FEHBP plans with Medicare–despite substantial opportunities to do so–and to conform with standard, indeed virtually universal, practice in the private sector and among state and local governments. This failure is very detrimental to the finances of

USPS, but also very detrimental to the interests of participants.

In FEHBP, annuitants (including Postal Service annuitants) pay 30% of the premiums for the plans in which they enroll, on average. Medicare Part A is free. Part B charges for most participants is $99.90 per month, which is about 25% of the value of the Part B benefit. Since Parts A and B are approximately equal in value (about $5,000 annually for each) those participants who elect to participate in both Parts A and B are paying about 12% of the total value of the benefit.

So, the failure to restructure the plans to assure participation in Medicare results in all participants—Medicare eligible annuitants, pre-65 annuitants and active employees alike—paying more in premiums than they would otherwise be required to pay. Stated more simply—it is a very bad deal for participants to decline to pay the 12% of the plans' costs that would be associated with participation in Medicare Parts A and B, and to have those costs shifted to a system in which participants pay on average 30% of the costs. But this fact is clearly not well understood by participants. In addition, it produces substantial inequity between those 75% of eligible annuitants who do participate in both Parts A and B, and the minority who do not enroll in Parts A or B or both. Correcting that inefficiency is the centerpiece of the USPS legislative proposal, and it is indisputably in the interests, not only of the Postal Service, but also in the interests of all participants.

A second inefficiency, also referred to by Mr. Francis, is what he calls "risk segmentation" and the "distortion of consumer choices." What this means is that the principal driver of what a plan costs in FEHBP is not the relative generosity of the plan's benefits compared with other plans, but how successful (or unsuccessful) the plan has been in attracting younger, healthier participants.

And beyond that, there is a reinforcing mechanism in distorting the relationship between cost and value, in this sense. When a plan has a population that consists of overweight and/or older participants and annuitants, in order to keep its pricing at least marginally competitive it has little choice but to reduce benefits. So a plan that is competitively disadvantaged in one year because costs are high and benefits not particularly generous, tends to become even higher in costs and less generous in benefits in reaction to that positioning, in subsequent years. Such plans eventually price themselves out of the market and withdraw from the system, which is what happened, for example, when Blue Cross/Blue Shield was effectively forced to eliminate its High Option Plan a number of years ago.

In a well-managed set of plans, the plan sponsor takes the steps to initiate and to maintain a consistent relationship between cost and value, and that is easily done, even when there is significant choice available to participants, with an appropriate spread between both the costs and value among the plan choices offered. That is not so easily done—and is essentially impossible, as the FEHBP program illustrates—where there are more than 200 plan options and each plan must be rated to the claims experience of the particular population it serves.

Another example of inefficiency is the redundant costs that are incurred and the economies of scale that are sacrificed by including so many very small plans within the system. Measured just by employees, the Blue Cross/Blue Shield plans (Standard and Basic) have some 63% of participants within the FEHBP system. That is more than adequate scale to assure that economies of scale are realized and to provide substantial leverage in negotiating favorable pricing arrangements from health care providers.

However, the next largest plan (the GEHA plan) covers less than 6% of all employees, so it is less than 1/10th the size of the Blue Cross/Blue Shield plans. The next largest plan (the APWU plan) and several other plans cover just under 2% of all employees, so they are about 1/30th of the size of the Blue Cross/Blue Shield plans. There are also a very large number of very small plans. More than 100 plans cover 5,000 or fewer employees. Some 50 plans cover 500 or fewer employees.

Many of the plans have their own claims system, some developed in-house and some rented or purchased from third parties. There are also redundancies in communications efforts, day to day administration, call centers and other infrastructure and administration requirements that inevitably sacrifice economies of scale or introduce other inefficiencies within the system.

The new USPS plan at the outset will have a much more streamlined, manageable system. The system will provide employee choice in a set of plans (high, middle and value) that will replicate the spread in actual value among the most generous and least generous FEHBP plans.

In addition, HMOs will be offered in those locations where there is significant concentration of Postal Service participants in such plans now, to avoid the disruption that would otherwise be involved in requiring all such participants to change their current provider relationship.

Participants will have—and will be able to evaluate—a consistent, direct relationship between the options offered and their cost. And, that relationship will be managed by the Postal Service, in partnership with the unions through the bargaining process, to assure that result for participants over time.

One final point is important. If the FEHBP system were the ideal system for managing a large, employer-sponsored health care plan, that would be the system used by the largest U.S. private sector health care plan sponsors, and by state and large local governments. It is not. Those systems virtually all use a system similar to what USPS is proposing, including:

1. Reasonable but not overwhelming employee choice;

2. Understandable choices where there is a direct correlation between cost to the participant and value, maintained over time by the plan sponsor;

3. A four-tier or similar system for determining the cost of dependents' coverage, which is more equitable in allocating costs among differently situated participants who need dependent coverage;

4. Comprehensive wellness and care management programs, specifically tailored to the needs of the participant population and the physical and other demands of their jobs; and,

5. **Full integration with Medicare, as a key component of affordability among those employers who continue to provide health care benefits to their retirees.**

We want our plan to mirror the best of private sector and state and local government design elements and operations, and to correct those inefficiencies and flaws found in FEHBP, which we and others have identified.

18. USPS has proposed that a USPS health plan be governed by a committee consisting of USPS and labor representatives. How would this committee work? Would it include representatives of both postal labor unions and management associations? Have unions or management associations expressed an interest in such a joint governing body? What role would the committee play in collective bargaining?

USPS has proposed the following governance process, which has been discussed with the leadership of our unions and management associations, and with other stakeholders including Congress, the administration, representatives of OMB and OPM and other interested parties:

1. **The plan would have an administration or governance committee, which would have equal representation from:**
    a. **USPS management, and**
    b. **Representatives of the unions and management associations.**
2. **The exact size of the committee has not yet been determined, nor its membership and the rotation schedule among the unions and management associations.**
3. **In addition to the management and bargaining representatives, there would be a neutral member of the committee to break deadlocks should they arise.**
4. **The draft Memorandum of Understanding (MOU) shared in negotiations with the NALC and the Mail Handlers also provides that there would be competitive bidding at periodic intervals unless both parties (management and the bargaining representatives) agree to waive this requirement. This requirement will prevent one party from indefinitely delaying periodic bidding, which will be essential to assure continued competitive pricing and commercial arrangements, regardless of the position of a neutral member of the committee.**

The unions and management associations have expressed interest in participating in the governance process, if a new USPS plan is established. The committee would not play a role in collective bargaining. That would continue to be the responsibility of the Postal Service and the particular unions, and that is also true of the consultation process with the management associations.

There are many similar models in place within the private sector, particularly among Taft-Hartley plans and collectively bargained plans, for example, for Amtrak's bargaining employees.

19. Does USPS believe its planned competitive bidding process will result in a sufficient number of qualified carriers to meet its stated goals?

As noted earlier, in December 2011, USPS conducted market research with many of the

large medical and pharmacy benefit managers, including Blue Cross and Blue Shield, Aetna, CIGNA, United Healthcare, Medco, Express Scripts Inc, and CVS/Caremark. All of the vendors expressed a keen interest in working with USPS and demonstrated through their written responses the ability to provide a comprehensive national provider network, and a strong commitment to partnering with USPS to meet our goals.

20. Under the USPS health care proposal, would both the premiums and benefits of a USPS-run health plan be subject to collective bargaining?

Yes, both are mandatory subjects of collective bargaining.

21 Under current law, in order for union workers to be required to join a USPS health care program, the plan would need to be agreed upon through the collective bargaining process. What concerns and objections have the unions and management associations expressed with regard to the USPS proposal for its health plan?

Realistically, the best answers to these questions would come directly from the principals involved—the leadership of the unions and the management associations. A common concern that has been expressed to us is, "What happens if the Postal Service should go out of business?" That concern has been principally expressed in the context of the coverage for annuitants.

We have explained in response to those raising the question that the liability for the current annuitants is already fully funded, i.e. that the current assets in the PSRHBF are already sufficient to cover the future premium cost for all current annuitants indefinitely into the future.

Moreover, the changes we have proposed will have the effect of significantly reducing the liability for current and future annuitants, especially through taking full advantage of the Medicare program consistent with essentially universal practice in the private sector and in state and local government programs. That reduction in liability, coupled with our plans to continue to fund for retiree health benefits to cover the amortization of the small remaining unfunded liability for current annuitants and future annuitants from the current active employee population, and to fund for new annuitants, should provide ample assurance to all current participants that their needs in this area are fully met.

Enactment of our proposal with these important changes is among the best ways to help assure not just the survival of the Postal Service, but that the organization is financially and operationally viable indefinitely into the future. That is an essential outcome for current employees and annuitants, as well as the entire mailing industry, recognized as a cornerstone of the U.S. economy.

We remain convinced that this proposal serves not just the interests of the Postal Service but that it is especially beneficial to the almost 2 million participants the new health plan will serve. We look forward to the continuing discussions with our unions and management associations that will certainly follow if Congress acts to give us the authority we are seeking.

22 Will USPS seek a portion of the FEHBP reserve fund in transitioning to its own plan?

The USPS seeks an equitable portion of the reserve fund that represents the portion no longer needed to maintain "Incurred But Not Reported Reserves" and Contingency

Reserves that are no longer needed to address financial insecurity of any particular plan. The reserves have been built up from payment of 104% of the expected claims costs, plus administration charges, and therefore a portion of the reserve fund is attributable to payments made by the Postal Service. As the size of the reserve fund needed for non-postal employees is smaller than that needed currently, a portion of the reserves can be released to USPS without affecting the remaining members in FEHBP.

Timeline of a USPS Default to the Taxpayer

23. USPS has stated that it plans to default on its retiree health prefunding payments of $5.5 billion due August 1st and $5.6 billion due September 30th and warned that it may still run out of money before the end of this calendar year.

a. Prefunding aside, what is the risk that USPS will run out of money this calendar year, considering the low cash balance it expects to reach this September and October? What about next year?

We do not "plan to default". We are working with the Congress and the Administration to avoid a default. However, the simple math will show that under no foreseeable circumstance will the Postal Service have sufficient funds to pay the $11.1 billion prefunding in 2012.

It is not possible to answer the question as to when we will run out of money with certainty. The Postal Service spends over $220 million per day, and must estimate cash flows of over $140 billion per year. Just a 1% error in total estimated cash flows, would result in a $1.4 billion change in projected cash balances a year hence. A commercial entity the size of the Postal Service should have access to cash totaling $7 billion at any point in time. At many points in the next 18 months our access to cash will be near zero—clearly not sufficient. Nonetheless, we have carefully planned our next 18 months and the results of these estimates are provided below.

As we have noted in briefings previously provided to the Committee, operating costs for the Postal Service are approximately $1.3 billion per week. Barring an unforeseen U.S. economic downturn, or increased acceleration of mail to moving to electronic means, we expect that our cash (liquidity) level will drop below $1.3 billion this summer and continue near that perilously low level, but above zero, throughout FY 2013. The large cash payments that are required to reimburse the Department of Labor for Workers' Compensation costs in October 2012 and 2013, make those months particularly problematic. However, the fall is also the start of our historically strongest revenue period and that helps to restore some liquidity. However, if our cost-saving efforts are legislatively restrained, our cash (liquidity) level could fall to zero by March 2013 and not fully recover.

b. Provide updated liquidity estimates for 2012 and 2013 that factor in USPS volume, revenue, and expenses for FY2012 to date and any updated projections.

For the first half of FY 2012, mail volumes and revenues have been slightly better than our original expectations, though still down from last year. Partially offsetting this are higher costs incurred for fuel and workload labor that resulted from the higher-than-expected volume. Moreover, we deferred implementation of certain cost-saving strategic initiatives, at the request of many members of Congress. Looking forward, potential slowdowns in the implementation of some

of our cost-saving strategies may further pressure our finances. The net effect of these various impacts is that we continue to expect that we will barely have sufficient liquidity to make it through CY 2012 and that the outlook for 2013 continues to look very challenging.

c What actions will USPS take to maintain sufficient liquidity? Will USPS consider stopping its FERS payments, as it did last year? Not making its workers' compensation payment due mid-October to the Department of Labor? Not covering USPS costs to participate in the FEHBP? What consequences would result if USPS defaults on these federal obligations?

The Postal Service will continue to fulfill its mission to deliver the mail, and it intends to fulfill its financial obligations to its customers, suppliers, and employees. This includes payments to other federal agencies relating to employee benefits, with one exception. The only payments that we absolutely cannot afford in the near term are the retiree health prefunding payments of $5.5 billion due August 1st, 2012 and $5.6 billion due September 30th, 2012.

In order to ensure that these commitments are fulfilled, certain legislative changes are needed. For example, the return of $11.4 billion in FERS overfunding and the adjustment of future FERS employer contribution rates for postal-specific experience and assumptions would provide the Postal Service with needed working capital, while continuing to assure that the FERS liability is fully-funded. Without these adjustments, the unnecessary overfunding of FERS will continue to grow. Likewise, adjustments to the Postal Service's health benefits program would provide significant additional financial flexibility.

In the event that legislative adjustments are not forthcoming, management of the Postal Service's liquidity becomes much more challenging. We are continuing to reduce costs wherever possible and generate new revenues and, as noted in the response to (a.), we expect to have sufficient liquidity through FY 2013, if our cost-saving efforts are not blocked by legislation or regulations. We cannot speculate as to any consequences that could result in the unlikely event that the Postal Service is unable to meet any of its future financial obligations, however maintaining service and making payments to our suppliers, contract partners and employees would be the highest priority.

In FY 2011, the Postal Service was forced to temporarily cease making its employer contribution to the FERS in order to ensure sufficient liquidity. Prior to making this difficult decision, the Postal Service determined that the temporary non-payment of the FERS employer contribution would not have any consequences for employees or annuitants, nor would it impact OPM's ability to make pension payments. Regarding current employees, the OPM took the position during the last fiscal year that employees would not earn creditable service during the period in which the Postal Service did not pay the employer contribution.

However, the Postal Service believed that OPM's view was inconsistent with the FERS statute, and we agreed to take our dispute to the Office of Legal Counsel (OLC) at the Department of Justice. In a decision issued last November, and recently shared with the Committee, OLC held that the FERS statute does not allow OPM to deny creditable service to employees on the basis of the Postal

Service's non-payment of the employer contribution.

Regarding current and future annuitants, the non-payment also would not have an impact, because it would not affect OPM's ability to make benefit payments either now or in the future. The employer contribution constitutes the Postal Service's share of the FERS normal cost for current employees, meaning it prefunds annuity payments that will occur in the future, when those employees retire. Thus, non-payment does not affect immediate benefit outlays to current annuitants, for which funds have already been set aside. Furthermore, a temporary non-payment of the contribution does not affect the ability of OPM to pay the annuity benefits of current employees once they retire, because the Postal Service's FERS account is substantially overfunded.

In contrast to the FERS payment, the workers' compensation payments to the Department of Labor (DOL) are used by DOL for immediate expenses. The Postal Service makes two payments to DOL in October, one to cover workers' compensation benefits paid to Postal Service employees (known as the "chargeback" payment), and another, much smaller, payment to cover DOL administrative expenses. We understand from prior discussions with DOL that the Postal Service's failure to make the chargeback payment at the beginning of the fiscal year combined with a failure by Congress to approve a unified federal budget by September 30, 2012, would leave DOL with insufficient funds to pay all workers' compensation benefits for Postal Service and other Federal employees by about November 2012, absent some form of additional funding to replace the Postal Service payment. In addition, we understand from prior discussions with DOL that a failure to make the payment for administrative expenses would affect DOL's ability to administer the system by about November 2012, again absent some form of supplemental funding through the unified federal budget or otherwise. However, if USPS were to make a partial payment, this could alleviate the impact on DOL's ability to pay compensation claims and administer the program.

The Postal Service's contributions under FEHBP are largely used to cover health benefits for employees and annuitants during the plan year in which the payments are made. However, portions of the contributions are set aside in a contingency reserve fund. The Postal Service has not consulted with OPM as to the possible consequences to employees and annuitants of stopping its contribution.

The Board of Governors would only consider suspending one or more statutorily-required payments after fully considering all relevant information, including the consequences of non-payment, and after determining that the non-payment was necessary to preserve liquidity so as to allow the Postal Service to continue providing prompt, reliable, and efficient delivery of the mail, consistent with its statutory obligations under title 39, United States Code. The Postal Service would consult with the Administration and Congress in advance of any suspension of a payment, in order to explain the decision of the Board of Governors and why that decision is consistent with the Board's statutory duties.

d Assuming no statutory changes, does USPS anticipate it will soon need congressional appropriations to make payroll and payments to contractors?

Barring an unforeseen U.S. economic crisis, or accelerated migration of mail beyond our expectations, we expect that our cash (liquidity) level will drop to a perilously low level, but above zero, throughout FY 2013. However, if our cost-saving efforts are legislatively restrained, our cash (liquidity) level could fall to zero by March 2013 and not fully recover.

USPS Financial Condition and Outlook

24 Provide updated projections of outstanding USPS debt at the end of each fiscal year from FY2012-2016, assuming that USPS prefunds retiree health benefits under current law and USPS borrowing were unconstrained by the current $15 billion statutory debt limit.

Assuming that none of the Postal Service's strategic initiatives are implemented and that retiree health benefits prefunding payments are made as scheduled under current law, projected debt levels would be as follows:

2012 - $28.0 billion
2013 - $39.7 billion
2014 - $54.1 billion
2015 - $71.6 billion
2016 - $92.1 billion

You should note that, at $15 billion dollars of debt, the Postal Service will be more highly leveraged than substantially all large investment grade commercial enterprises, and, absent a clear path forward, it would be inappropriate to allow these balances to grow.

25 Provide updated projections of USPS mail volume, revenues, and expenses for FY2012 that factor in results for the fiscal year to date and updated projections for the rest of the year.

We are currently in the process of closing the books on Quarter 2 of FY 2012. These results will be available in mid-May and will serve as the basis for an updated projection of our FY 2012 financial results and our initial planning for FY 2013. We are also developing scenarios that allow us to examine the potential impact of changes to our plan, such as those that might occur as a result of Congressional action.

We have identified the following relevant information.

- **During the first half of FY 2012, mail volumes and revenues have been better than plan (though still down from last year).**
- **Partially offsetting this trend are higher costs incurred for fuel and workload labor that resulted from the higher-than-expected volume.**
- **The implementation of certain strategic cost-saving initiatives has been delayed at the request of some members of Congress, adding more pressure to our finances.**

26 Provide estimated USPS savings achieved in each of the past five fiscal years, and updated savings projections for FY2012.

In the past five fiscal years, we have achieved incremental annual savings that total $13.7 billion, as shown below. Without these savings, our 2011 net loss of $5.1 billion would have been approximately $19 billion.

Year	Incremental Annual Savings ($ billions)
2007	$1.2
2008	$2.0
2009	$6.1
2010	$3.0
2011	$1.4
Five Year Total	$13.7

Based on preliminary results through March, we are estimating that 2012 savings will be approximately $1.9 billion, exclusive of any costs for separation incentives (if any).

a How much of the FY2012 savings depends on future workforce attrition and future realignment of USPS's operations?

The Plan to Profitability calls for a reduction of close to 66,000 people by the end of FY 2012. Of this amount, approximately 30,000 people are directly linked to the change in Service Standards and the consolidation of mail processing facilities, which the Plan assumed would be fully implemented by the end of FY 2012. Delays in the implementation of this initiative will have a small financial impact in FY 2012, but will have a significant financial impact in FY 2013.

b. How much of the FY2012 savings will not be realized if USPS decides to maintain current service standards and extend the moratorium on closing facilities?

The potential impact to FY 2012 from further delaying the change in Service Standards and the consolidation of mail processing facilities is relatively small and represents a loss of approximately $200 million in savings. However, the impact on FY 2013 would be dramatic, as the Plan assumes full implementation of this initiative in order to realize $2.0 billion in savings.

As we have noted in many of our communications, our liquidity situation remains extremely challenging. We project that we will be operating throughout much of FY 2013 with less than one week's worth of available liquidity. If we are unable to implement our strategic initiatives on a timely basis, this would put extreme pressure our finances.

27. Wage costs continue to constitute about half of all postal costs and traditionally have increased on the basis of cost-of-living adjustments (COLA) keyed to the Consumer Price Index (CPI).

a. Provide USPS trend data on wage costs and additional USPS costs resulting from wage increases for each fiscal year from FY 2001-2011, including total compensation and work hours, compensation per work hour and its annual percent change, and the additional costs due to compensation increases.

Fiscal Year	Total Compensation & Benefits Expense* ($ millions)	Total Nat'l Workhours (thousands)	Hourly Rate	Annual Percent Change
FY 2001	$ 48,853	1,603,034	$ 30.48	
FY 2002	$ 49,046	1,527,422	$ 32.11	5.4%
FY 2003	$ 47,822	1,473,793	$ 32.45	1.1%
FY 2004	$ 49,582	1,452,321	$ 34.14	5.2%
FY 2005	$ 51,599	1,463,253	$ 35.26	3.3%
FY 2006	$ 53,386	1,458,729	$ 36.60	3.8%
FY 2007	$ 53,306	1,423,001	$ 37.46	2.4%
FY 2008	$ 52,358	1,373,354	$ 38.12	1.8%
FY 2009	$ 50,883	1,258,025	$ 40.45	6.1%
FY 2010	$ 48,909	1,182,947	$ 41.35	2.2%
FY 2011	$ 48,310	1,148,837	$ 42.05	1.7%

* Excludes workers compensation and retiree health benefits expenses.

b. Provide budgeted USPS data (from the Integrated Financial Plan) for the same fiscal years for wage costs, total compensation and work hours, compensation per work hour, and annual costs due to compensation increases.

Fiscal Year	Total Compensation & Benefits Expense* ($ millions)	Total Nat'l Workhours (thousands)	Hourly Rate (includes COLA)	Annual Percent Change
FY 2001	N/A	N/A	N/A	N/A
FY 2002	$ 52,970	N/A	N/A	N/A
FY 2003	$ 53,021	1,497,422	$ 35.41	N/A
FY 2004	$ 49,679	1,455,487	$ 34.13	-3.6%
FY 2005	$ 51,111	1,446,056	$ 35.35	3.6%
FY 2006	$ 52,787	1,445,670	$ 36.51	3.3%
FY 2007	$ 53,119	1,421,347	$ 37.37	2.4%
FY 2008	$ 53,163	1,381,612	$ 38.48	3.0%
FY 2009	$ 52,138	1,223,516	$ 42.61	10.7%
FY 2010	$ 48,787	1,179,778	$ 41.35	-3.0%
FY 2011	$ 48,527	1,142,208	$ 42.49	2.7%

* Excludes workers compensation and retiree health benefits expenses.

28. In your testimony, you stated that labor costs account for 80 percent of USPS total costs, and 38% of personnel costs are tied to federal benefits programs outside of our control.

a. Why did USPS voluntarily agree last year to guarantee COLAs and general wage increases in the collective bargaining agreement with the American Postal Workers' Union (APWU)? Isn't it true that the first COLA payable next year will increase USPS annual expenses by $215 million? Considering USPS's looming insolvency, aren't these wage increases unaffordable? Why is USPS not following the example of other bankrupt enterprises and publicly asking APWU to reopen this ill-advised contract?

The Postal Service's current contract with the APWU eliminated pay raises for two years. Even with the general increases and COLAs after the two-year pay freeze, as compared to the previous contract, the new contract was estimated to save the USPS $3.8 billion based on the complement and attrition projections available at that time. As such, the responsible course to take was to conclude the agreement and realize the significant cost savings.

COLAs are paid under the contract semi-annually. The first COLA payable under the APWU contract will be in March of 2013. Based on the latest available projections, this is expected to add about $24 million in annual expenses. The next COLA payable under the APWU contract will be in September 2013. Based on the latest available projections, this is expected to add $221 million in annual costs from that point forward.

The Postal Service does not have a legal avenue to force the APWU to reopen negotiations. Unlike companies in the private sector, the Postal Service does not have the option to resort to bankruptcy proceedings.

b. Why is USPS currently paying nearly 100-percent of the health and life insurance premiums for its executives? Should USPS executives lead by example and immediately pay the same share as other federal employees?

The Postal Service has taken several proactive steps to restrain compensation for its leadership and to lead its workforce by example, not only by enacting pay freezes for its officer corps in the form of a salary freeze and/or non-payment of performance lump sums for the past four consecutive years, but by also voluntarily making the decision in November 2010 to change health benefit contribution levels for all Postal officers and executives. Beginning in 2012, the Postal Service share of the health benefit premium was reduced to 91 percent of the federal weighted average premium, and will continue to decrease in 2013 and 2014 until the percentage matches the percentage paid by employees in the rest of the federal government.

Although the Postal Service made this decision in recognition of projected financial pressures, it was not one that was made lightly due to the existing and notable discrepancies in base salary and performance award pay between Postal Service Executives and Federal Government SES employees. In FY2010 (the latest available data from OPM), the average Postal Service's executive salary was $140,898, while that of the Federal Government's SES level was $167,049, a significant difference of $26,151. The following differences should also be noted from a performance awards perspective:

Fiscal Year	Postal Executive Average Performance Award	Federal Government SES Average Performance Award
FY2010	$10,663	$13,081
FY2011	$0	$11,181*

Source OPM Report on Senior Executive Pay and Performance Appraisal Systems for FY2010.
** Average estimated based on OPM's announcement on Budgetary Limitations for Awards dated 6/10/2011. http://www chcoc gov/Transmittals/TransmittalDetails aspx?TransmittalID=3997*

Regarding FEGLI, the value for the average Postal executive is approximately $558 for Postal executives, a relatively small benefit considering the significant level of scope and responsibilities that come with an executive position, and the existing compensation differences between the Postal Service and Federal Government.

Even with the Postal Service paying for the full cost of health insurance and certain FEGLI premiums for its executives, this only translated to a $4,040 benefit value over what was provided by the Federal Government, still leaving a sizeable pay gap of $22,111 between the Postal Service executives and Federal Government SES in FY 2010.

c. Why does USPS not increase the share of health and life insurance premiums paid by other non-bargaining employees to the same portion paid by other federal workers?

The Postal Service is statutorily required to engage in a process of consultation with the management associations prior to issuing changes in pay policies affecting such non-bargaining employees. That process is underway, and the Postal Service has advanced the position in that process that the employer contribution rate for health insurance premiums should be reduced to the level paid by federal employees.

d What is USPS's strategy for reducing its career workforce to 400,000 employees? What specific actions will USPS take to incentivize retirement?

To reduce the size of the workforce the Postal Service has traditionally utilized attrition. On a number of occasions the Postal Service has used Voluntary Early Retirement and or retirement incentives to increase attrition. The Postal Service will most likely have to offer Voluntary Early Retirement and incentives over the next four years to reduce the workforce.

Nearly half of our roughly 550,000 career employees are eligible to retire or participate in a voluntary early retirement. We forecast annual attrition of approximately 30,000 career employees. We believe we can reduce our workforce to 400,000 career employees with a combination of retirements and incented separations. This is based, in part, on the success of our 2009

incented separation program which had 21,000 participants. We continue to work with our labor unions and management organizations on the terms of retirement or separation incentives.

29. According to annual data reported by USPS, the aggregate cost of postal labor increased 7.1 percent in FY 2009, 1.8 percent in FY 2010, and 5.4 percent in FY 2011. (See Total Factor Productivity table 14, available at http://www.prc.gov/Docs/80/80526/ChIR2.Q28.xls.)

a. Does this cost growth include or exclude payments to prefund retiree health benefits? Please specify the costs that are factored into these data.

Total Factor Productivity (TFP) is an economic estimate of the excess of outputs over resource inputs. For the Postal Service, TFP is calculated by comparing mail volume, adjusted for workload content and deliveries to all labor, material and capital resources used. The 2009 – 2011 TFP calculations include an estimate of the retirement health benefits (RHB) attributable to current service. For each of these years, approximately $1.5 billion was attributed to each year as an estimate of the normal (service) cost of RHB earned each year.

The Postal labor component of TFP includes all personnel-related costs (adjusted as described above) with the exception of the interest and discount rate adjustment to the workers' compensation liability, which is not considered a resource usage, merely a valuation change and the remaining RHB prefunding, which is not associated with any year's work.

b. Why did the aggregate cost of postal labor increase by 5.4 percent in FY2011?

The FY 2011 increase of 5.4% in the Price of Aggregate Labor Input represents the increase in the unit cost of the labor component of the TFP calculation. This was driven primarily by: (a) an increase in contingent and short-term liability expenses associated with employee claims, and (b) the significant increase in workers' compensation expenses associated with the actuarial revaluation of existing cases.

30 USPS has long reported that the decline of profitable First-Class Mail volume is a key reason for declining USPS revenue. Provide the total volume, revenue, and contribution of First-Class Mail for FY 2000 through FY 2011, as well as breakdowns for single-piece and bulk First-Class Mail and estimates for future First-Class Mail volume

Historical First-Class volumes, revenues, and contribution are shown below.

Total Domestic First-Class Mail				
(in millions)	Volume	Revenue	Attributable Cost	Contribution
FY 2000	103,525.7	$35,515.9	$19,423.5	$16,092.4
FY 2001	103,655.6	$35,874.0	$19,768.5	$16,105.5
FY 2002	102,378.6	$36,479.0	$19,135.0	$17,344.0
FY 2003	99,053.5	$37,041.3	$17,908.7	$19,132.6
FY 2004	97,921.0	$36,370.9	$17,458.8	$18,912.1
FY 2005	98,066.0	$36,052.2	$18,469.1	$17,583.1

FY 2006	97,614.1	$37,030.5	$19,239.5	$17,791.0
FY 2007	95,895.3	$37,551.0	$19,220.1	$18,330.9
FY 2008	91,276.7	$37,276.6	$18,264.2	$19,012.4
FY 2009	83,313.7	$34,955.0	$17,240.2	$17,714.9
FY 2010	78,549.2	$33,131.1	$16,454.7	$16,676.4
FY 2011	73,210.2	$31,314.0	$15,483.6	$15,830.3
First Class Single Piece (in millions)*				
			Attributable	
	Volume	Revenue	Cost	Contribution
FY 2000	55,088.8	$22,333.5	$13,594.4	$8,739.1
FY 2001	53,599.3	$22,003.0	$13,546.1	$8,456.9
FY 2002	51,922.5	$22,044.5	$13,393.9	$8,650.6
FY 2003	49,104.2	$21,804.5	$12,889.6	$8,914.9
FY 2004	47,682.3	$21,081.9	$12,543.2	$8,538.8
FY 2005	45,892.8	$20,260.9	$12,583.0	$7,677.9
FY 2006	44,365.6	$20,295.2	$13,053.5	$7,241.7
FY 2007	42,260.6	$20,156.1	$13,029.2	$7,126.8
FY 2008	35,355.6	$14,854.0	$8,889.6	$5,964.4
FY 2009	31,633.2	$13,753.5	$8,342.0	$5,411.5
FY 2010	28,584.9	$12,752.8	$7,775.4	$4,977.3
FY 2011	25,846.8	$11,580.8	$7,184.6	$4,396.1
First Class Presort (Bulk) (in millions)*				
			Attributable	
	Volume	Revenue	Cost	Contribution
FY 2000	48,436.9	$12,999.7	$4,800.2	$8,199.4
FY 2001	50,056.3	$13,687.0	$5,131.2	$8,555.9
FY 2002	50,456.2	$14,227.0	$5,160.5	$9,066.5
FY 2003	49,949.3	$14,994.5	$4,966.9	$10,027.5
FY 2004	50,238.7	$15,009.7	$4,860.6	$10,149.1
FY 2005	52,173.3	$15,521.0	$5,361.4	$10,159.6
FY 2006	53,248.6	$16,488.0	$5,786.8	$10,701.2
FY 2007	53,634.7	$17,174.8	$6,190.8	$10,984.0
FY 2008	51,935.9	$17,060.0	$5,723.9	$11,336.1
FY 2009	47,933.7	$16,282.1	$5,607.2	$10,674.9
FY 2010	46,225.4	$15,975.3	$5,398.8	$10,576.5
FY 2011	44,494.5	$15,488.4	$5,183.6	$10,304.8
First-Class Flats (in millions)*				
			Attributable	
	Volume	Revenue	Cost	Contribution
FY 2008	3,379.7	$4,056.3	$2,571.0	$1,485.3
FY 2009	2,864.5	$3,539.9	$2,157.5	$1,382.4
FY 2010	2,484.0	$3,117.7	$2,148.0	$969.8
FY 2011	2,230.9	$2,814.2	$1,946.4	$867.8
First-Class Parcels (in millions)*				

	Volume	Revenue	Attributable Cost	Contribution
FY 2008	605.5	$1,120.8	$1,079.7	$41.0
FY 2009	580.8	$1,113.8	$1,095.2	$18.6
FY 2010	574.4	$1,131.2	$1,132.4	($1.2)
FY 2011	638.0	$1,284.5	$1,169.0	$115.5
** Breakouts of First Class Flats and Parcels were not available until FY2008				

Estimates for future First-Class Mail volume are as follows.

Total First-Class Mail	
(in billions)	
	Volume
FY 2012	67.2
FY 2013	64.2
FY 2014	60.1
FY 2015	56.3
FY 2016	52.9

31. In its Annual Compliance Determination for FY2011, the Postal Regulatory Commission (PRC) reported that "Standard Mail Flats generated revenues $643 million less than its attributable costs, yet USPS has repeatedly failed to utilize existing pricing options to address this growing Standard Mail intraclass subsidy." What is USPS's response to this statement?

The Commission is referring to the limited pricing flexibility that is available to the Postal Service under the "cap" mechanism. Under that mechanism, it is indeed possible to address the issue the Commission identifies; however, price increases for Standard Mail overall (which includes a much higher volume of advertising letters) must stay under the inflation-based "cap". For instance, if the Postal Service were to greatly increase the prices for "Flats", it would have to offset those price increases through lower prices on other Standard Mail. There would not be a net financial gain since the average has to stay within the cap; in fact, large price changes could have a negative financial implication.

In the FY 2010 Annual Compliance Determination, the Commission directed the Postal Service "to increase the cost coverage of the Standard Mail Flats product through a combination of above average price adjustments, consistent with the price cap requirements, and cost reductions until such time that the revenues for this product exceed attributable costs."[3]

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[3] 2010 Annual Compliance Determination at 106. The Postal Service sought judicial review of this directive because it is (1) contrary to the express terms of the PAEA, (2) beyond the Commission's authority in the context of its review of an annual compliance report, and (3) arbitrary and capricious in that the Commission failed to address the argument that such a course of action may actually result in less contribution and, therefore, have a negative impact on the Postal Service's financial stability The court recently concluded that the Commission's decision was arbitrary and capricious.

In FY 2011, as a class, Standard Mail had a cost coverage of 147.6%, an increase from the FY 2010 cost coverage of 146.6%. Therefore, the Postal Service continues to remain in full compliance with 39 U.S.C. §3622(c)(2), which requires that market-dominant products cover costs as a *class*, not on a product-by-product basis.

In its Notice of Rate Adjustment, (Docket R2012-3), filed with the Commission on October 18, 2011, the Postal Service increased the price of the Flats *product* by more than the average price increase for Standard Mail. In order for the Postal Service to maximize its revenue, it looks at Standard Mail as a *class*. If it had increased Standard Mail Flats prices by a higher percentage, the overall increase for the Standard Mail Class would still have been the same, since other products would have had to be increased by a lower amount, in order to stay within the price cap.

The Postal Service remains concerned about the financial health and long-term viability of the catalog industry, a major user of the Flats product, and so the Postal Service has used its pricing flexibility to keep Flats price increases moderate, even though the product's price increase is slightly above the cap. This approach reflects ongoing concern that the condition of the catalog industry and the economy generally suggest that substantially larger than average Flats price increases may result in volume declines that may undermine the viability of this product. In addition, potential operational changes, including network optimization, could substantially reduce operating expenditures. Thus, a balanced approach of moderate price increases in conjunction with cost savings will, over time, begin to address the cost challenges faced by this product.

Non-postal Initiatives

32. You testified that USPS is in the process of establishing a group to take a lead on digital transmission. What are USPS's plans for "digital mail" service? In answering this question, provide the Committee with full answers and redacted responses for the record.

a Describe options that USPS has considered in this area, particularly those that remain under consideration, the investment that would be necessary to enter this highly competitive area, and the expected profits, if any, in the first five years.

- **Digital Group - A 'digital group' has not yet been established. However, the U.S. Postal Service is committed to seeking ways to innovate.**

- **Digital Mail - Under the *Postal Accountability and Enhancement Act* [Title 39, Section 102 (5)] a postal service is defined as "the delivery of letters, printed matter, or mailable packages, including acceptance, collection, sorting, transportation, or other functions ancillary thereto...". The Postal Service is also largely forbidden from providing non-postal services. As written, this statute restricts U.S. Postal Service innovation to exclude pure digital services where all aspects of the production, transmission and delivery of mail are digital in nature. Thus, to be permissible under current law, digital services must have a relationship to the production, transmission, or delivery of hardcopy mail. Therefore, no pure digital services without the requisite connection to hardcopy mail are being considered or developed at this stage.**

- **Solutions Under Consideration - In line with its current authority, the Postal**

Service has been evaluating how it may support innovation of the physical mail / package experience through the use of technology. This focus has been on "hybrid" solutions where some aspects of the production, transmission and delivery of mail leverages technology but also involves hard copy. (An example of this type of solution includes the Apple card mobile app where consumers are able to create greeting cards via their mobile phone and subsequently have those cards physically created through Apple's print facility and entered into the mailstream). Options under consideration involve developing hybrid solutions to help customers better manage their physical mail and packages. To broaden the scope of innovation, this could include making assets of the organization available for private sector providers to scale existing and/or new hybrid tools. It also includes development of hybrid tools that the American public would only trust the U.S. Postal Service to develop and manage on their behalf.

- **Investment for Innovation –The Postal Service is considering investments in innovative solutions while supporting other innovations across the mailing industry. Investments recently made to the usps.com platform will be leveraged in the organization's effort to enhance its constituents' experience around mail and package management. The Postal Service does not plan to make investments to position itself as a competitor to the mailing industry.**

b. How much has USPS spent on digital mail service? What expenditures are planned? Report annual expenditures to date and budgeted expenses for FY2012, including on information technology and on USPS employees, consultants, and contractors working on this effort.

- **Digital Mail Spending - The Postal Service has not spent funds on digital mail services. Rather, the organization has spent funds to evaluate its constituents' needs (consumers as well as businesses) and how it may leverage its assets to support innovation in the mailing industry. This work is focused on how the organization's involvement could benefit consumers as well as businesses as it does today via its physical network.**

- **Research & Strategy Spending - The Postal Service has retained the Boston Consulting Group (BCG), a leading strategy consultancy, to provide guidance on how the organization should approach digital innovation. BCG has supported other postal organizations around the world in their efforts to develop feasible innovation strategies. To date, the organization has spent $1.7 million on research and strategy consulting services.**

In FYs 2010 and 2011 combined, approximately $1 million was spent studying potential digital mail services. In the first six months of FY 2012, approximately $2.6 million has been spent on digital mail services, compared to an FY 2012 total expense budget of $6.5 million. This includes the cost of all employees, consultants and contractors associated with this effort.

c. What management review and approval has been given to digital mail and related initiatives? Provide Decision Analysis Reports and other documents reviewed by USPS management and the Board of Governors

- **Management Review & Approval - Postal Service management has only approved the evaluation of the role the organization could play to support**

innovation in the mailing industry. No approval has been granted to pursue digital mail initiatives which are prohibited by the *Postal Accountability and Enhancement Act* [Title 39, Section 102 (5)] mentioned earlier. Accordingly, no Decision Analysis Reports or other formal analyses or evaluations exist.

Mail Processing

33. USPS reports that as of 2011, it eliminated approximately 200 mail processing facilities in the past five years while providing a "soft landing" for employees through retirements and reassigning staff. In Figures of your testimony, you project the elimination of over 200 more mail processing facilities by 2013. In closing these facilities, what is your projected workforce reduction?

The Network Rationalization concept, including the proposed service standard rule change and the consolidations, is projected to result in a workforce reduction of approximately 30,000 employees.

34 What criteria and methods does USPS adopt to determine whether to close or consolidate facilities? Specifically, how did USPS select which mail processing facilities to close?

A least cost optimization model was used to assign mail volume by 3-Digit ZIP Codes to processing plants based on the proposed operating concept. The model output was used as a framework for discussion with subject matter experts to determine the feasibility of the consolidation opportunities. The opportunities were adjusted based on expert insight and became the basis for the Area Mail Processing (AMP) feasibility studies.

An AMP study is an iterative process that determines whether a consolidation is feasible, if a valid business case exists, and if the consolidation is in the best interest of the Postal Service. This process incorporates public input into the final decision. The feasibility is examined by determining if the volume can be transported to the new site and processed within the required processing window with mail processing equipment that will physically fit inside the facility. The business case estimates are based upon the projected expenses of mail processing labor, management, transportation, and equipment and facility maintenance. The public input process is used to modify the consolidation plan as necessary to meet customer needs.

35. Total mail volume peaked at 213 billion pieces in FY2006 but dropped to 168 billion pieces by FY2011 and is expected to drop to 144 billion pieces by 2016 According to some mailers, at its peak, USPS had the capacity to process up to 300 billion pieces of mail each year.

a. How much excess processing capacity does USPS have in mail processing? Please summarize the higher costs resulting from excess capability and give some supporting examples.

   Historically, to a great extent, postal mail processing and transportation network infrastructure and mail processing technology have been configured and designed to accommodate pursuit of the service standards applicable to First-Class Mail, with considerable emphasis on meeting overnight service standards.

   The benefits of automated Delivery Point Sequencing (DPS) are so substantial that the Postal Service has invested considerably in such equipment and has expanded facility capacity to accommodate the machinery. Investment in additional machinery and facility space was prudent and affordable during periods when mail volume was more robust and growth could confidently be predicted.

However, overall volumes have declined sharply, and the mail mix has changed, yet service standards and the mail processing network required to meet those standards have remained the same.

To maximize the volume that can benefit from DPS on any given delivery day, the operation must be conducted during a narrow time window before dispatch. This window occurs in the early morning hours of each delivery day in order to ensure that a maximum degree of First-Class Mail with an overnight service standard can reach this downstream operation and meet its delivery standard.

The combination of the overnight service standard and short DPS processing window inherently requires the USPS to maintain excess capacity. The majority of DPS processing equipment is solely used for DPS processing and thus remains idle throughout the remainder of the day.

Therefore, significantly more DPS equipment is required to be available to operate at more mail processing plants (or large Post Offices) than would be required with an expanded operating window, due to the relaxation in First-Class Mail service standards. This equipment occupies more total floor space, requires the deployment of more maintenance personnel and supplies at more locations, and generates more operating cost than if other operational and service requirements were in effect. Also, the transportation being operated between mail processing plants and from each plant to its subordinate delivery is higher than it would be than under different circumstances.

b Summarize the benefits that USPS expects to achieve from increasing mail processing operations from 5-6 hours a day to 16-20 hours a day.

By expanding the processing window and relaxing the overnight service standard, the number of pieces of equipment required to process DPS could be significantly reduced. This larger operating window also allows mail to be transported further distances to be processed. Therefore, fewer pieces of equipment are required and are able to be consolidated into fewer facilities nationwide. This results in a reduction of approximately half of the existing USPS processing facilities. This would result in fewer trucks going between fewer facilities, fewer maintenance personnel required to maintain fewer facilities and machines, and fewer management personnel required to oversee fewer operations.

The expanded operating window and altered mailer entry times will provide an environment in which all DPS volume is at the facility, ready to be processed at noon each day. This allows the USPS to be able to staff and schedule personnel according to the known mail volume. The annual savings associated with expanding the operational window by way of a relaxation in First-Class Mail service standards is estimated to be approximately $2.5 billion per year.

c. How many more processing facilities would USPS need to close in order for processing capability to match the declining workload?

The number of processing facilities in the network is determined by the First-Class Mail service standards. The change of these standards will allow the USPS to consolidate approximately half of the existing processing facilities within the

network with today's mail volumes. The proposed First Class service standard change provides the framework to continue to consolidate facilities as volume continues to decline.

Post Offices and Retail Postal Service

36 Postmaster General/CEO Patrick R. Donahoe said that USPS is "developing a number of alternatives to closing post offices that could sustain offices in rural communities." However, over 70% of the post offices the USPS in the Retail Access Optimization Initiative (RAOI) are in rural Zip Codes.

a. What criteria has USPS used to select post offices for the RAOI? To remove them from the RAOI?

The initial RAOI process was a "top down" look at Post Offices. It was never the intention that all offices identified in RAOI would be discontinued or closed. These facilities were selected to be "studied" to determine the probability of discontinuance. The criteria for selecting offices to place in the RAOI study were as follows:

Group 1: Less than $27,500 in annual revenue and less than 2 hours of earned daily workload. This group included an exception for the state of Alaska where the criteria of $27,500 was reduced to $10,000 in annual revenue.

Group 2: Less than $600,000 in annual revenue and five or more access points within 2 miles.

Group 3: Less than $1 million in annual revenue and five or more access points within ½ mile.

Group 4: This category of facilities includes Post Offices that were undergoing locally-initiated discontinuance studies under the guidelines of the previous USPS Handbook PO-101. These offices were brought forward into the new provisions as Group 4 and represented approximately 260 Post Offices.

There are no established specific criteria for removing an office from the RAOI. This is done on a case-by-case basis. The precise reason the RAOI offices were selected by Headquarters for "study" is that from the Headquarters level we cannot know all of the local issues that a closure would create. The community meetings as well as the logistics play a role in the process. To date, 432 RAOI identified offices have been removed from the list.

b What savings does USPS project from closing post offices remaining on this list?

Initially, the Postal Service estimated the savings under the RAOI to be up to $200 million in savings "if" every office identified for study closed.

RAOI is an established process that begins with Headquarters submitting a list of offices to the field for consideration. Once receiving the list from Headquarters, local management has a prescribed course of action, following Postal Regulations and Federal Law that involves notifications, community meetings/input, and a localized study of the proposed closures impact. Because of the very nature of these requirements, it is not possible to predetermine which offices will eventually

be closed and which will remain open; therefore, there is no probability of making an accurate projection of the potential savings to be realized. Historically, studies have sometimes resulted in offices being taken off the list. That impact cannot be calculated until each study is completed.

As you reference in your question, the Postal Service is considering other alternatives to match retail service with community demand that do not necessarily require facility closures while still achieving savings objectives.

c. USPS removed offices from this list and posted a list of "safe" offices Given that non-rural offices comprised only 30% of the original list, why are 50% of the "safe" offices classified as non-rural?

The Postal Service is not aware of any "safe" list of offices. The very nature of RAOI was that Headquarters would generate a list of offices fitting the specific criteria listed in question 7(a), and then the local offices would conduct operational studies and get community input. Local management would then analyze the feasibility of the proposed discontinuance and submit their findings/conclusions to Headquarters for a final determination. Some offices have been removed from the initial RAOI list as a result of a case by case review, but they have not been placed on a "safe" list because operational changes may result in further considerations, which could lead to a future discontinuance.

37. Effective May 23, 2011, Article 7.3 A.1 of the APWU Collective Bargaining Agreement, prohibited Post Office employers from hiring any part-time regular clerk staff The Agreement also prohibited Level 21 and above Post Offices from hiring part-time flexible clerk staff Our Committee is concerned that the inability to use a sufficient number of part-time employees impairs effective and efficient customer service. Specifically, over-reliance on full-time employees to meet peak load demand at Level 21 and above Post Offices results in expensive idle time costing USPS more than $40 per hour in wages and benefits.

a Would a greater reliance on part-time employees help address customer service concerns such as longer lines at peak times?

There will not be a greater reliance on full-time employees as a result of the APWU collective bargaining agreement. While the losses of part-time regular and part-time flexible resources cited above are correct, the agreement also afforded the Postal Service a new low cost flexible resource, the Postal Support Employee (PSE). We are allowed to hire PSEs to 20% of career complement. We do plan to utilize this new flexibility to help address customer service concerns such as longer lines at peak times.

b. Compared to the heightened reliance on full-time employees, how much would USPS save if it had the flexibility to hire more part-time employees?

As stated above, there is not a heightened reliance on full-time employees. To the contrary, the new National Bargaining Agreement signed with the APWU allows for greater flexibility than prior to the agreement, as we are now permitted to add non-career PSE's. The PSE workforce is a skilled non-career workforce that can be trained to work in retail operations as well as scheme trained for sorting mail. PSE's can represent 20% of the entire Customer Service and Retail workforce, and may exceed the 20% cap filling any position identified as "new work". The new language also introduced the Non-Traditional Full Time Employee, which allows the Postal Service flexible new ways in which to define a full-time employee

ranging from working 6-days per week at 6-hours per day, up to 10-hours per day, 4-days per week.

c. With a greater reliance on full-time employees, how much idle time has USPS logged for clerk staff? Provide data displaying all clerk staff hour logs, including idle time and over-time for FY2010-FY2011.

As discussed above, there is not an increased reliance on full-time employees. As shown below, APWU clerk hours decreased by 5.3% in 2011, while casual (non-career) clerk hours increased by 10.4%. In addition, overtime hours for the APWU clerk craft decreased by approximately 98,000, while overtime hours worked by casual employees increased by almost 47,000.

USPS Clerk Hours				
	2011		2010	
	Hours	% of Total Wkhrs	Hours	% of Total Wkhrs
Overtime				
Bargaining	17,475,452	6.5%	17,573,947	6.2%
Casuals	419,697	0.2%	372,858	0.1%
Consolidated	17,895,149	6.7%	17,946,805	6.3%
Workhours				
Bargaining	260,007,956	96.6%	274,491,315	97.1%
Casuals	9,038,832	3.4%	8,186,579	2.9%
Consolidated	269,046,788	100.0%	282,677,894	100.0%
Workhour % change over 2010				
Bargaining	-5.3%			
Casuals	10.4%			
Consolidated	-4.8%			

The Postal Service does not maintain comprehensive idle time logs.

38. How has the agreement with APWU—which included no layoff protection, limited excessing of employees, limited outsourcing and returned thousands of jobs that were subcontracted back to postal employees provided USPS with flexibility to effectively realign its workforce?

The Postal Service has a number of tools to adjust and reduce its complement. The provisions of Article 12 provide for involuntary reassignments from positions no longer required to needed positions in the same or different crafts. Article 12 also permits

withholding of vacancies for future placement of such employees. Attrition, thus, can be used to reduce the overall complement numbers as well as for the reassignment of existing employees. Given the tenure and retirement eligibility of a sizeable percentage of APWU employees, there is at least the potential for significant attrition. Use of the Voluntary Employment Retirement Authority can increase that rate. In addition, non-career employees can be terminated at any point for lack of work, and there are programs in place to encourage voluntary reassignment to needed positions.

39. USPS claimed the agreement with APWU would save USPS close to $4 billion over its 4 1/2 year life. However, there is little transparency of the basis of this claim or what the true financial effects will be of the agreement. Provide the following information with the supporting documentation for each financial estimate, including supporting assumptions.

a. To date, how much savings has the USPS generated under this agreement? Provide data from FY2010 and FY2011 demonstrating these savings.

Our estimates indicate that the APWU agreement produced savings of approximately $100 million during FY 2011 (the contract was effective for just over four months of FY 2011). In addition, we estimate that for the first six months of FY 2012, the agreement has produced an additional $275 million in savings.

b. What is the USPS expected savings under this agreement in FY2012-FY2016? Provide data supporting your assumptions.

In March 2011, we estimated that cumulative FY2012-FY2015 operating savings from the APWU contract would add up to $3.8 billion. That estimate excluded the cost savings impact of our Strategic Initiatives (Networks, Delivery, and Retail) and Five-Day delivery. Additionally, the $3.8 billion cost saving estimate was based on higher mail volume projections than the ones reflected in our current Plan to Profitability.

The annual savings originally estimated in March 2011 are shown below.

Sources of savings:	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	Total
Noncareer workforce flexibility	$53	($59)	($311)	($559)	($682)	($1,558)
New career pay schedule	($13)	($32)	($57)	($86)	($162)	($350)
Salary freeze & COLA deferral in 2011 & 2012	($189)	($426)	($516)	($323)	($315)	($1,769)
Health benefits	$0	$0	($32)	($61)	($87)	($180)
Total	($149)	($517)	($916)	($1,029)	($1,245)	($3,857)

Critical assumptions that were made in developing these estimates include the mix of career and non-career employees, health benefits cost increases and the growth in the CPI.

Thus far, savings under the APWU agreement have been generally in line with expectations. The APWU contract gives management a much higher degree of flexibility to react to changes in mail volume than had been previously available.

In addition, we have the opportunity to further expand the pool of non-career employees to a greater extent than was considered in the original analysis, which may create the opportunity to realize further savings. Future savings may also be dependent on the outcome of Postal reform legislation, which may dictate the extent to which we can enact our strategic initiatives or other cost savings measures.

APWU Contract

40 According to the 2010-2015 collective bargaining agreement between USPS and the American Postal Workers' Union (APWU, USPS must insource at least 600 Postal Service Vehicle (PVS) routes when their contracts expire. USPS and APWU also agreed to review about 8,000 other existing Highway Contract Route (HCR) contracts.

a Does this still make sense in light of USPS plans to streamline its mail processing network and related transportation and eliminate costly in-house excess capacity?

Yes, mail will continue to be transported, even in a streamlined network. In addition, 75% of the work returned to the APWU will be assigned to lower-cost non-career PSE's. The hourly wage of PSE drivers is no more than $15.85 an hour, with certain limited exceptions. PSE's can be utilized to drive the excess equipment capacity and replace the cost of the HCR contracts.

b. How much will these insourcing provisions raise USPS costs? Provide supporting documentation. If no documentation was prepared, explain why USPS entered into this provision without this fundamental analysis.

A determination was made during negotiations for the APWU agreement that there were 600 routes that could be returned in-house without net additional cost. The Postal Service chose the 600 routes to convert and anticipated that the majority of the driving work on the HCR routes could be absorbed into existing PVS routes. These routes have recently been determined and verified.

c. How many PVS and HCR routes have been insourced to date? How many are planned to be insourced by the end of this calendar year? Next calendar year?

The HCR routes that will be returned in-house to create 600 PVS routes will take place by July 1, 2012. Additionally, the Postal Service will review HCR routes each year for the next 3 years. The review of each route will determine if the HCR route (or a portion thereof) can be performed at a lower cost by PVS drivers. A decision will then be made based on cost, overall operational needs and customer service.

d For each PVS and HCR route that has been insourced, provide the cost comparison that USPS conducted prior to insourcing and explain why the route was insourced, particularly if outsourcing the route would have been the best value. If no cost comparison was conducted, please explain why.

The Postal Service agreed to return a limited amount of work to the APWU as part of the overall negotiated agreement. The 600 HCR routes will be returned on or about July 1, 2012. The original cost comparison was based primarily on absorption of the work into routes currently driven by Postal Vehicle Service drivers. For any additional HCR routes to be reviewed, a cost comparison will be performed. Consideration of all overall operation needs, including wage rates,

fleet needs, maintenance capabilities, vehicle parking, and route logistics will be made prior to the insourcing of any routes. In addition, the termination of any HCR contract must not incur or cause any additional cost to the Postal Service.

e. Provide any other cost comparisons that have been completed under this USPS-APWU agreement for other PVS or HCR routes.

No other cost comparisons have been done.

41 The 2010-2015 USPS-APWU collective bargaining agreement listed 20 Contract Postal Units (CPUs) that were required to be closed, regardless of their profitability and value to customers, In addition, USPS agreed to meet with APWU whenever USPS requests USPS consider options for additional full-service CPUs or any new or existing CPUs in close proximity to USPS retail facilities.

a. Why did USPS agree to close the 20 CPUs? What were their overall revenues and contribution to USPS's financial well-being?

The Postal Service agreed to close the 20 CPU's (out of the approximately 3,600) as part of the overall negotiated agreement with the APWU, which resulted in billions of dollars of labor cost savings. The Postal Service selected the 20 facilities to be closed. The majority of the CPU's selected were in close proximity to existing post offices where the same type of retail products and services were being offered. These post offices have absorbed the work performed at the CPUs that were closed. No net loss of revenue is anticipated. The total revenue for the 20 offices in 2011 was $5.2 million dollars, which includes $252,000 in box rental. The post offices in close proximity have taken over the box rental. The revenue is also offset by compensatien to the CPU vendors of $1.42 million in 2011.

b. Has USPS entered into further discussions with APWU regarding other CPUs? If so, what was agreed on? Provide minutes and documentation of any such meetings.

Meetings were held with APWU representatives on September 26, October 3 and 19, and November 22, 2011. No additional CPUs are scheduled to close at this time. The Postal Service does not prepare or maintain meeting minutes for such meetings.

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