STATEMENT OF THE HONORABLE DAN G. BLAIR
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before the

COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

on

THE REPORT OF THE PRESIDENT'S COMMISSION
ON THE UNITED STATES POSTAL SERVICE

FEBRUARY 24, 2004

Madam Chairman and Members of the Committee:

I am pleased to be here today on behalf of the Director of the Office of Personnel Management, Kay Coles James, to discuss the Report of the President's Commission on the United States Postal Service.

We wish to commend the Commission for its service to the President, the Postal Service, and all of the citizens of this great nation. Its report is the result of a monumental effort. While no such blueprint can be adopted without careful examination and adjustment, it represents a thoughtful review of a complex subject, and an excellent starting point to address the nation's postal needs. Their efforts laid the groundwork to aid Congress and the Administration as we begin to evaluate what changes are necessary to respond to the rapidly fluctuating demands of the Postal Service in the 21st century.

Before I go on to specifics, I would be remiss if I failed to express our admiration for the tireless efforts of Postmaster General Jack Potter in his leadership of the Postal Service. Last November, he testified before you that he looked forward "to working with this Committee and with the Congress to identify the business model that will enable the Postal Service to serve everyone in America, today and far into the future."[1] We look forward to participating in support of that goal, and are confident that our combined efforts will be rewarded with success.

Your invitation asked OPM to address three items related to the Commission's Workforce Recommendations – performance-based compensation systems, collective bargaining for pension and retiree health benefits, and funding of accrued military service retirement benefits for postal employees covered by the Civil Service Retirement System.

[1] Testimony of John E. Potter, Postmaster General/CEO United States Postal Service, before the Committee on Governmental Affairs, United States Senate, November 5, 2003, www.usps.com/communications/news/speeches/2003/sp03_pmg1105.txt .

Madam Chairman, let me address the first of these items regarding performance-based compensation systems. The President's Commission suggested that:

> The Postal Service should undertake a careful study of performance-based compensation programs for both management and represented employees, and it should work with the unions and management associations to design and implement a performance-based compensation program that is meaningful to Postal Service employees and assists the Postal Service in meeting its productivity and service quality goals.[2]

The Administration strongly supports performance-based pay systems, and Director James whole-heartedly supports the Commission's recommendation in this regard. Performance-based pay systems are a critical element of the President's Management Agenda.

Performance-based compensation systems have been around for decades in the private sector, and experimentation and evaluation of such systems within the Federal government dates at least back to the late 1970's, with Federal personnel demonstration projects leading to agency-wide efforts in the Federal Aviation Administration and the Internal Revenue Service. Virtually without exception, experience under these systems has shown that they can work. It takes preparation and commitment, but where these exist, organizations (including many in the Federal Government) have been able to make meaningful, performance-based pay distinctions in a way that is fair and equitable and sends the right message to those who demonstrate the highest performance.

To be successful, the performance plans these systems are based on should include the following key features:

- Establish expectations up front;
- Deal with demonstrable results; and
- Be linked to an Agency's Strategic Plan and Annual Performance Plan.

So, when an individual is evaluated one will be able to answer the question, "This is what I expected of you, this is what you did. So how did they match up?"

Additionally, pay-for-performance plans can serve as a recruitment tool for organizations by attracting those job seekers who are turned off by the idea that their performance will not be rewarded. It can be an incentive for "hard chargers" to join an organization.

Our ability to successfully introduce these performance-based pay systems into Government hinges on our measurement and assessment of performance. Measures must be results-oriented – as opposed to process – based. This is a natural evolution of the Government Performance and Results Act which led to improved organizational performance metrics and tying agency performance to Annual Plans.

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[2] *Embracing the Future: Making the Tough Choices to Preserve Universal Mail Service*, Report of the President's Commission on the United States Postal Service (Washington, D.C. 2003) p. 177

Madam Chairman, we believe that this can be done. We believe agencies can develop compensation systems which make meaningful distinctions among performers.

Last year, the President began building the foundation by proposing a pay-for-performance system for the Federal Government's Senior Executive Service (SES), as well as a special "Human Capital Performance Fund" to reward top-performing front-line Federal employees with base pay increases. Thanks in large part to the efforts of this Committee, Congress passed both initiatives, and in so doing, established a number of excellent "design principles" that will govern implementation.

Madam Chairman, with your help, we are clearly moving from experimentation to implementation, and you can rest assured that OPM, under the leadership of Director James, will do everything within its power to make sure this is done the right way.

The second point you asked us to address concerns the Commission's recommendation that the "responsibility for funding Civil Service Retirement System benefits relating to military service of postal retirees should be returned to the Treasury Department." I would like to explain why we disagree, and to respond to the specifics of the Commission's report concerning the Civil Service Retirement System (CSRS).

When the Postal Service was established by Public Law 91-375 more than three decades ago, the Congress made a fundamental policy decision. Noting that the Service has received congressional appropriations from time to time, it has been the policy of the United States that the operations of the Postal Service should be self-sustaining. As noted in a 1970 Committee report on the bill: "Rates are to be set so that each class of service pays at least its own identifiable costs and so that revenues of the postal service as a whole meet its expenses, taking into account appropriations that the Congress may chose to make to cover the loss of revenue on congressionally declared free and reduced rate mail."[3]

Sixteen years later, the Congress made another fundamental policy decision, this time with regard to the funding of Federal retirement benefits. When it enacted the Federal Employees' Retirement System [FERS] Act of 1986, the Congress decided that it would not permit the creation of an unfunded liability through an underfunded retirement system. Instead, the full costs of benefits would be funded by employer and employee contributions sufficient to totally defray the long-term costs of the benefits provided.

There are many elements of the benefit structure creating those costs, including eligibility criteria, creditable service, and benefit computation. While credit for military service is one element of that structure, it is not singular in nature. It is simply one element among many. What is significant is that each and every agency, including the Postal Service, is responsible for all of those costs under FERS.

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[3] H.R. Rep. No. 1104, 91st Cong., 2nd Sess. (1970), 1970 U.S.C.C.A.N. (Vol. 2) 3659

When OPM discovered in 2002 that statutorily mandated payments to the Retirement Fund from the Postal Service would eventually over-fund Postal CSRS obligations, Director James worked within the Administration to promptly prepare and submit legislation to ensure that the Postal Service paid only its fair share. In doing so, we followed the FERS funding model. While the CSRS benefit structure is different, the computation and responsibility for costs are on the same basis as is applicable to the Postal Service and all other agencies under FERS. Through your leadership, the Congress approved this legislation and it was signed into law by President Bush last April. Significantly, it saved the Postal Service approximately $78 billion, and should permit the Postal Service to defer rate increases. It was simply the right thing to do.

The Commission's report asserts that no other Federal agency is required to fund military service credit for its CSRS employees, but that is simply not relevant in this matter.[4] Public Law 108-18, the "Postal Civil Service Retirement System Funding Reform Act of 2003," was intended to provide for accurate funding of Postal CSRS costs. It was not intended to put the Postal Service on the same plane with other agencies, which do not pay the full cost of CSRS benefits for their employees. The appropriate, "good-government" response to the under-funding issue is to require all agencies to pay the full cost of CSRS, not to give the Postal Service a discount from the real cost. I would note that full funding of CSRS is not a partisan issue, and that both this and the prior administration did in fact submit proposals to the Congress that would have required all agencies to pay the full costs of CSRS service in a manner similar to that under FERS.[5]

We are also troubled by other aspects of the Commission's stated rationale behind its recommendation. In particular, we disagree with the Commission's view that "it is inappropriate to require the Postal Service, as a self-financing entity that is charged with operating as a business, to fund costs that would not be borne by any private-sector corporation."[6]

The Commission seems to be asserting that there should be a new public policy. That new policy would require the Postal Service to pay the costs that it would be subject to as a private corporation, taking into account all of the minuses attributable to its status as a Governmental entity, but ignoring the benefits resulting from that status. We believe this concept to be misguided.

It is recognized that the Postal Service is a unique national resource that operates under extraordinary circumstances. Yet, it is impossible for it to operate like a private corporation in important ways. It has significant public service obligations, such as universal service, to which the private sector is not subject. Its ratemaking structure is subject to significant administrative review and its ability to manage its assets, such as post offices and facilities, receives great scrutiny. In recognition of these public service obligations, it also has significant advantages not shared by private corporations, including a broad statutory monopoly and freedom from many state and local tax and regulatory requirements. Indeed, the Service was granted significant

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[4] *Embracing the Future: Making the Tough Choices to Preserve Universal Mail Service* p. 125

[5] The "Federal Retirement Accrual Accounting Amendments of 1995" was submitted in the 104th Congress, and the "Managerial Flexibility Act of 2001" in the 107th Congress.

[6] *Embracing the Future: Making the Tough Choices to Preserve Universal Mail Service* p. 125

assets in real estate and other property worth billions of dollars when it was established in 1971 and the Service was not required to reimburse taxpayers for these assets.

Federal retirement is an exceptionally useful recruitment and retention tool that is unavailable to the private sector, with benefits guaranteed by the full faith and credit of the Government of the United States. Since the Postal Service has and uses this human capital tool, it should pay for its full cost. Federal retirement benefits are not served from an a la carte menu. There is no basis for the Postal Service to choose to pay for what it likes, and to receive the rest for free, subsidized by taxpayers. It is a package deal.

Moreover, the basic principle, which Congress appropriately has recognized, is that the Postal Service should pay its costs of operation. Further, this was one of the guiding principles enunciated by the President as essential for Postal reform. Thus, we respectfully take issue with the Commission's recommendation to single out the cost of CSRS military service credit as if it was a unique item in a vacuum.

The Commission's assertion that existing policy "asks those who use the nation's postal system to subsidize the U.S. military every time they use the mail" is unfortunate and inaccurate.[7] Providing retirement service credit has nothing to do with any subsidy for the military. On the other hand, the Commission gives no credit to the added value that military service does provide through the exceptional training and experience that makes veterans better prepared to be useful and productive Postal Service employees.

Before departing from this area, I ask you to think about one more aspect of the subject. The Commission's suggestion is limited to CSRS. Yet, if it is adopted, would such action be establishing a precedent for consideration of other retirement subsidies, such as assessing financial responsibility for military service credit under FERS?

We have adopted full funding for FERS. We have adopted full funding for Postal CSRS. Accepting the Commission's recommendation on this subject would move us in the wrong direction in establishing principles of fiscal responsibility. I would urge this Committee not to take any action which would permit the overall principle of Postal self-funding to be carved away, a piece at a time.

Director James deeply respects the work of the President's Commission. However, we strongly believe that its recommendation on this matter is fundamentally flawed. The bottom line is that the Postal Service should fully fund the costs of its operations, and retirement service credit for military service is part of that cost.

Finally, your invitation asked that we comment on the potential impact on Federal systems of making the Postal Service's post-retirement health benefits and retirement benefits subject to collective bargaining. We are currently working to prepare the report on this subject, which was requested by you, Madam Chairman, along with Senator Carper, on January 9th. Director James intends to respond, as you requested, with detailed answers to the questions that were posed to

[7] *Ibid.,* p. 126

OPM in your letter, and we have already been consulting with our colleagues at the Postal Service. While it is premature to fully discuss the details of this complex subject, I would like to spend a few moments going over some of the issues involved.

The Commission would make retirement "eligibility requirements and employee contributions" negotiable[8]. Negotiation of how the normal cost percentage[9] is divided should not pose a problem, since the Postal Service will pay the difference between the employee rate and the normal cost percentage. However, negotiation of the benefit structure could pose significant challenges. Retirement funding is based upon predictability and continuity. We note that there has never been a major group severed from either CSRS or FERS and placed in a separate structure. Thus, any new Postal retirement system must be carefully designed with full integration incorporated (including mechanisms for dealing with service split between Postal and non-Postal employment) in order to avoid any ensuing problems or complications.

Another area the Commission would make negotiable is the "eligibility and retiree contributions under the post-retirement" component of Federal Employees Health Benefits (FEHB)[10]. Our report will detail the issues and potential impact to the program raised by the Commission's recommendations. However, we would point out that current FEHBP does not distinguish between active employees and retirees, nor are benefits tailored to any specific agency or its employees.

FEHB is a life-time program, with the major plans experience rated based upon the actual cost of benefits used by enrollees. Changing the composition of the enrollment group has a direct affect upon costs. While we do not know what options the Postal Service is considering, adverse selection could occur if a plan were developed allowing the Postal Service to take active employees out of the system while leaving retirees in under either the current system or a new system with negotiated arrangements. To do so threatens to drive up average costs in the FEHB program in a manner that would be completely unacceptable to Director James, who, as you know, has fought long and hard on behalf of our Federal employees to contain costs, including premium increases.

Further, if the Postal Service took over health benefits responsibility for its employees and retirees, it would place the entire risk and responsibility for health benefits in the hands of the Postal Service, but could potentially reduce the number of fee-for-service plans.[11]

I would also bring to the Committee's attention that between 1995 and 2002, several agencies that had used their independent compensation authority during the 1980s to offer employees an alternative health insurance plan outside of the FEHB Program came to the Congress for

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[8] *Ibid.*, p. 176

[9] While the technical definition is more detailed and complex, in essence the "normal cost percentage" is the percentage of salary that must be contributed at the time service is performed in order to pay the full cost of retirement benefits, assuming that the contributions begin at first employment, and that the system will continue.

[10] *Embracing the Future: Making the Tough Choices to Preserve Universal Mail Service* p. 176

[11] Only the Blue Cross Blue Shield Service Benefit Plan and GEHA (Government Employees Hospital Association) Benefit Plan would be available to all employees.

legislative relief. One by one, they requested legislation that allowed them to make all of the current and future retirees eligible for FEHB coverage in retirement[12]. The legislation that was enacted in behalf of each of those agencies granted OPM authority to restore FEHB eligibility to their current and future retirees with an appropriate payment to the trust fund to cover the liability. While employees in those agencies had retained FEHB eligibility, in the short-term, many found the alternative coverage they were offered more attractive. However, the assumption of those agencies that in the long run they could provide more attractive health care plans and coverage for their employees on their own proved to be wrong. They found that the purchasing power of more than 8 million plan enrollees could not be readily duplicated. As healthcare costs overall began to increase significantly, their premiums were subject to much larger annual increases than those in the FEHB Programs and their benefits and coverage were reduced as well. Thus, they wisely sought to drop their alternative plans and ensure that all of their employees and retirees would have coverage under the FEHB Program. I believe this history is instructive for the Committee in considering proposals which could potentially lead to a severance of a substantial number of enrollees from the program.

In conclusion, Madam Chairman, on behalf of Director James, thank you for inviting the Office of Personnel Management to testify on this matter. I will be glad to answer any questions you may have.

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[12] The agencies allowed to enroll in the FEHBP, the effective date of the enabling legislation, and the dates their enrollments became effective, are: 1. Farm Credit Administration (Agriculture, Rural Development, and Food and Drug Administration Appropriations Act of 1996, PL 104-37, approved October 21, 1995, FEHB coverage effective January 7, 1996.), 2. Federal Deposit Insurance Corporation (Federal Employees Health Care Protection Act of 1998, PL 105-266, approved October 19, 1998, FEHB coverage effective January 1, 1999), 3. Federal Reserve System (Federal Employees Health Care Act Protection Act of 1998, PL 105-266, approved October 19, 1998, FEHB coverage effective January 1, 1999), 4. Office of the Comptroller of the Currency (FEGLI Living Benefits Act, PL 103-409, approved October 25, 1994, FEHB coverage effective January 8, 1995), 5. Office of Thrift Supervision (FEGLI Living Benefits Act, PL 103-409, approved October 25, 1994, FEHB coverage effective January 8, 1995), 6. Overseas Private Investment Corporation (PL 107-304, approved November 27, 2002, FEHB coverage effective January 26, 2003).