

**S. 2082—THE INTERNATIONAL POSTAL SERVICES  
ACT OF 1998**

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**HEARING**

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL SECURITY,  
PROLIFERATION, AND FEDERAL SERVICES

OF THE

COMMITTEE ON  
GOVERNMENTAL AFFAIRS  
UNITED STATES SENATE

ONE HUNDRED FIFTH CONGRESS

SECOND SESSION

ON

**S. 2082**

TO AMEND CHAPTER 36 OF TITLE 39, UNITED STATES CODE, TO PRO-  
VIDE AUTHORITY TO FIX RATES AND FEES FOR DOMESTIC AND  
INTERNATIONAL POSTAL SERVICES, AND FOR OTHER PURPOSES

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JUNE 2, 1998

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Printed for the use of the Committee on Governmental Affairs



U.S. GOVERNMENT PRINTING OFFICE

49-590 cc

WASHINGTON : 1998

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**S. 2082—THE INTERNATIONAL POSTAL  
SERVICES ACT OF 1998**

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**TUESDAY, JUNE 2, 1998**

U.S. SENATE  
SUBCOMMITTEE ON INTERNATIONAL SECURITY,  
PROLIFERATION, AND FEDERAL SERVICES,  
OF THE COMMITTEE ON GOVERNMENTAL AFFAIRS,  
*Washington, DC.*

The Subcommittee met, pursuant to notice, at 2:10 p.m. in room 342, Senate Dirksen Building, Hon. Thad Cochran, Chairman of the Subcommittee, presiding.

Present: Senators Cochran, Levin, Cleland, and Stevens.

**OPENING STATEMENT OF SENATOR COCHRAN**

Senator COCHRAN. The hearing of the Subcommittee will please come to order.

I would like to welcome our witnesses and others who are attending this hearing today on S. 2082, the International Postal Services Act of 1998, which I introduced a few weeks ago.<sup>1</sup>

This bill would amend Section 3621 of Title 39 of the U.S. Code to subject international postal services to review by the Postal Rate Commission. The authority of the Board of Governors and Postal Rate Commission to collect and review postal service data on costs, volumes, and revenues for each rate category now extends only to domestic mail. Therefore, the regulators, Congress, and the general public cannot examine data to support statements by the Postal Service that international mail is covering its attributable costs.

Allegations have been made that the Postal Service uses its revenues from first class mail to subsidize its international postal services. The Postal Service denies this, stating that the Postal Reorganization Act prohibits the Postal Service from using the revenues from one service to reduce the price of another.

When Congress passed the Postal Reorganization Act of 1970, no specific language was included that would grant the Postal Rate Commission jurisdiction over international postal services, as it was granted for all domestic postal services. Instead, the authority to set international rates was left solely to the Postmaster General. The Postal Reorganization Act, in its legislative history, provides very little guidance on the oversight of the Postal Service's rates for international mail services.

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<sup>1</sup> Copy of S. 2082 appears in the Appendix on page 43.

This morning we will hear from two panels of witnesses. The first will include William J. Henderson, Postmaster General, and Einar Dyhrkopp, Vice Chairman of the U.S. Postal Service Board of Governors. The second panel will include Christopher J. McCormick, Senior Vice President of Advertising and Direct Marketing at L.L. Bean, Inc., Fred Smith, Chairman and CEO of the FDX Corporation, and James P. Kelly, Chairman and CEO of United Parcel Service.

We have also received written statements from other interested persons, and we will include those statements in our hearing record.<sup>1</sup>

Senator COCHRAN. I am pleased to yield for any comments or statement from our distinguished Ranking Member of the Subcommittee, Senator Levin.

#### **OPENING STATEMENT OF SENATOR LEVIN**

Senator LEVIN. Mr. Chairman, thank you.

The question of how these international postal rates should be set may sound like a technical issue to some, but it involves some very important issues of equity, of competitiveness, and some other very significant and broad policy issues. The importance of this issue is signified by the panels that we have with us today, by who is on those panels, and also by the fact that this room is so crowded that there are people waiting to get into it.

So, Mr. Chairman, I think the significance of this hearing is apparent, and I look forward to hearing the different perspectives on this, including the history of the current approach; issues about the fairness of the current approach; and the competitive advantages and disadvantages of the current approach, and I will join you in taking a very close look at how we currently approach this issue and whether or not there should be any change in the way we adopt these rates.

Senator COCHRAN. Thank you, Senator.  
Senator Cleland.

#### **OPENING STATEMENT OF SENATOR CLELAND**

Senator CLELAND. Thank you very much, Mr. Chairman. We are delighted to be with all of you here today, and especially I am delighted to welcome the Postmaster General and the staff, and it's nice to be with our friends from UPS, which happens to be located in Georgia, and my good fellow Vietnam veteran, Fred Smith and company. I am delighted to be here with you and I look forward to the hearing and the questions. Thank you.

Senator COCHRAN. Thank you very much.

We could now invite our first panel to come forward: Postmaster General Henderson and Mr. Dyhrkopp.

We appreciate very much your providing us copies of your statements in advance. We will make those a part of the hearing record in full, and encourage you to make whatever comments in summary or in detail as you think would be helpful to the Subcommittee.

Mr. Henderson.

<sup>1</sup> Other statements provided for the record appear in the Appendix on pages 67-78.

**STATEMENT OF HON. WILLIAM J. HENDERSON,<sup>1</sup> POSTMASTER  
GENERAL, U.S. POSTAL SERVICE**

Mr. HENDERSON. Thank you and good afternoon, Mr. Chairman and Members of the Subcommittee. With me is the Vice Chairman of the Postal Service Board of Governors, Einar Dyhrkopp. We are pleased to be here today and welcome the opportunity to speak with you about the proposed International Postal Services Act of 1998.

Mr. Chairman, I appreciate that you took the time to discuss this legislation with me last month. I believe the dialogue we've begun will lead to a solution that resolves the concerns behind S. 2082 and protects the best interests of the Nation and America's mailers.

When you introduced this legislation, you raised two questions: One, do international mail services pay their own way? And two, should Congress put international rates under the jurisdiction of the Postal Rate Commission as they did with domestic rates in 1970 when the Postal Service was created?

The answer to the first question is yes. International services do pay their own way, and more. As you pointed out when introducing the bill, cross-subsidies between different classes of mail are prohibited under postal ratemaking statutes. In each rate case, the Postal Service must demonstrate to the Postal Rate Commission that total international revenues exceed international costs. This ensures that domestic services, such as First-Class Mail, are not subsidizing international ones.

The law also provides a remedy to those who believe the Postal Service is charging domestic rates that don't conform to these requirements. They can file a complaint with the Rate Commission, which has jurisdiction to investigate and recommend remedial action to the Governors of the Postal Service. This remedy, in conjunction with the ratemaking process, makes it unlikely that an actual cross-subsidy could be established, or even survive. Our performance bears this out. Our international business has run a surplus in each of the last 5 years. Last fiscal year, 1997, we grossed \$1.61 billion from our international business. Attributable costs were \$1.34 billion, and the surplus was \$273.2 million. Those results have been certified by independent auditors.

Consequently, rather than customers paying higher domestic rates to support international services, international services are making a contribution to our overhead that helps keep domestic rates down.

I believe these facts, and the established safeguards, are a compelling response to the cross-subsidy issue. Nevertheless, in view of the Subcommittee's interest, we are taking further steps. The Board of Governors has asked the Inspector General of the Postal Service to conduct an audit of the allocation of costs between the Postal Service's domestic and international products and services. Their findings will be reported to the Board and to you, and this will provide an objective, factual foundation for answering the cross-subsidy issue. If any weaknesses emerge during this review, you have my personal assurance that the Postal Service is willing and ready to work with you to correct them.

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<sup>1</sup> The prepared statement of Mr. Henderson appears in the Appendix on page 57.

## QUESTION AND ANSWER FOR THE RECORD SUBMITTED BY THE U.S. POSTAL SERVICE

1. *What was the origin of the limitation of the jurisdiction of the Postal Rate Commission in the area of international rates at the time of Postal Reorganization in 1970?*
  - A. It is our understanding that international rates were not an issue at the time of the Postal Reorganizational Act of 1970. Unlike domestic rates, international rates were not set by Congress and there appears to have been general agreement that the international rate-setting process was working well. The domestic rate-setting process, however, was under Congressional control, and this needed to be changed as part of the overall reform of postal finances. When the domestic rate setting function was removed from Congress, it was neither necessary or desirable to change anything about the way international rates were set.

This brings us to the second issue, whether international rates should be placed under the domestic price-setting system.

As you might expect, we firmly believe the answer is no, for three reasons. First, unlike domestic letter mail, our international postal business is not protected by the Private Express Statutes. Everything we do in this field is subject to marketplace competition. The market is the driving force regulating international postal services. Any party whose prices were subject to regulation would be at a unique disadvantage. In our case, it would take 10 months to change prices. In addition, closely-held proprietary information on markets and pricing strategy would be an open book to other firms and hundreds of other postal administrations.

Second, we are not dealing with a single, uniform market, but hundreds of marketplaces. Each has its own laws, customs, and market nuances. For example, in Germany, Deutsche Post plans to go public in the year 2000, while in China we are dealing with a state-run institution with a complex bureaucratic overhead. In every country, circumstances are different. Transportation costs vary from border to border and change constantly. Currencies fluctuate daily. Tariffs and entry requirements can be raised and revised at any time. This places a premium on our ability to act quickly and to tailor specific customer solutions under widely varying conditions.

Further, the domestic ratemaking process wasn't designed to handle the unique requirements of international mail. It would create an administrative nightmare for regulators. We have about 10 products and services that go to hundreds of countries. There are 189 postal administrations represented at the Universal Postal Union alone. The actions of these nations determine about half of the international mail costs in the form of terminal dues. We pay them to deliver U.S. mail on their soil. We have limited influence on these costs, which are driven by the internal dynamics in the individual countries.

My third point is that none of this would be in the best interest of our customers. It would tend to drive us out of the international marketplace and deprive consumers and businesses of all sizes of a valuable service alternative. Under current law, we have used flexibility in international services to design and implement Global Package Link, a service that helps American companies sell to individual customers abroad.

We have negotiated service agreements that meet special price or service needs of a variety of mailers. In every case, we have opened

doors to foreign markets for American customers by providing them choice and value.

Placing international services in a domestic ratemaking format would just simply take away that flexibility. As I mentioned earlier, postal rate proceedings typically take 10 months. In addition, the negotiated service agreements customers expect in international markets are not available before the Postal Rate Commission. Without them, we would expect to lose a large number of our valuable customers; but more to the point, they would lose us, the U.S. Postal Service.

For these reasons the Postal Service strongly believes that the approach taken in S. 2082 goes well beyond what might be needed to resolve the issues it is intended to address. Nevertheless, we are ready to do our utmost to debunk the allegations of cross-subsidization to the full satisfaction of this Subcommittee. We ask, however, that in doing so we do not compromise the ability of the Postal Service to serve its customers or to remain viable in world markets.

We are entering a new era of globalized postal services. Foreign postal administrations are buying private delivery firms. They are setting up shop in other nations; that includes right here at home. We believe it is imperative that the U.S. Postal Service retain its ability to respond. We are the bridge between universal mail service at home and international markets. This Nation and our customers need that bridge to remain strong, open, and toll-free.

That concludes my prepared remarks. Vice Chairman Dyhrkopp would now like to make a statement.

Senator COCHRAN. Thank you, Mr. Henderson.

Mr. Einar Dyhrkopp is Vice Chairman of the U.S. Postal Service Board of Governors.

Mr. Dyhrkopp, we will hear from you, and then we will have an opportunity to have questions for both of you.

Senator STEVENS. Mr. Chairman, could I interrupt for just a minute?

Senator COCHRAN. Senator Stevens.

Senator STEVENS. I'm sorry, I wanted to stay, but we have an Appropriations Subcommittee markup. I am very interested in this subject and I will welcome the chance to review the statements. I congratulate you for holding this hearing, because I think it should be publicly aired, but I do think we ought to wait for the Inspector General's report before we go much further. Thank you.

Senator COCHRAN. Thank you, Senator Stevens, very much.

Mr. Dyhrkopp.

**STATEMENT OF EINAR V. DYHRKOPP,<sup>1</sup> VICE CHAIRMAN OF THE BOARD, U.S. POSTAL SERVICE BOARD OF GOVERNORS**

Mr. DYHRKOPP. Thank you, Mr. Chairman. I am pleased to be here with Postmaster General Henderson to discuss the international mail services of the U.S. Postal Service. As the Vice Chairman of the Board of Governors of the Postal Service, in the absence of Chairman Winters who is out of the country on personal travel, I want to lend the support of the Governors to the Postmaster General's statement before you today.

<sup>1</sup> The prepared statement of Mr. Dyhrkopp appears in the Appendix on page 58.

I also want to assure you and the other Members of your Subcommittee that the Board of Governors take very seriously our oversight responsibilities, as well as our role in the ratemaking process. As you know, this takes on even greater significance in the international mail area where the Postal Reorganization Act authorizes the Postal Service to set international rates.

Mr. Chairman, with that in mind, I would like to take a step back in history. The Postal Service authority over international rates was bestowed by the Nation's first Congress in 1851, and was continued under the Postal Reorganization Act in 1971. In creating the Postal Service in 1970, the Congress divested itself of the practice of Congress setting domestic rates. Instead, Congress established shared responsibilities for setting these domestic rates in the Postal Rate Commission and the Postal Service. However, it also left in place the century-old practice of having the Postal Service set the international rates. Indeed, Section 403 of the Postal Reorganization Act specifically directs the Postal Service to arrange for the delivery of written materials and parcels "throughout the world," and to provide such other incidental services as it finds "appropriate to its functions and in the public interest."

As the postal administration of the United States, with the authority over international mail and rates, the Postal Service is also uniquely suited to represent the United States at the Universal Postal Union, where it can deal and has dealt directly and effectively with the postal administrations of other countries. In fact, the Postal Service is a leader in the Universal Postal Union. The Postal Service has taken a leading role in important UPU work and has been effective in assisting the UPU to be more responsive in a rapidly changing world.

The question as to whether international rates should be placed under the domestic price-setting system is troubling to the Board. Here again the Postmaster General has laid out several compelling arguments as to why the present system is in the best interest of the American public, with which the Board agrees.

With the international arena largely a deregulated environment, the Postal Service faces serious competition. The Postal Service is but one of many customer choices, including several domestic private courier services. In addition, several foreign postal administrations have set up shop here in the United States and are aggressively competing for the international business. All of these domestic and international competitors are unregulated.

The Board is very concerned over the allegations that international mail services are being cross-subsidized with Postal Service domestic products and services. The Postmaster General very effectively communicated that this is prohibited under existing ratemaking statutes. We have been assured by management in discussions on international mail services that that has not occurred, and will not occur.

We now have the benefit of a certification by an outside CPA firm, retained by the Board of Governors, establishing that domestic does not subsidize international rates. There is an additional layer of protection in having a firm independent of the organization certify the accuracy of costing and revenue data.

Nevertheless, the Board has also taken a further step to address the allegations which gave rise to this bill. We have asked the independent Inspector General of the Postal Service to conduct an audit into the cost relationships between domestic and international postal services. Their findings will be reported to us and made available to you. This should provide an objective review and a factual foundation for answering the cross-subsidization question. As the Postmaster General has indicated, and we fully support, the Postal Service is willing and ready to work with you to implement practical solutions to any problems that emerge.

Mr. Chairman, in closing I want to assure you and the Members of the Subcommittee that the Board of Governors of the Postal Service were unanimous in our selection of Bill Henderson as our new Postmaster General. We look forward to working with Bill and fully support him in his future direction of the Postal Service.

Mr. Chairman, that concludes my prepared remarks. We will be happy to answer any questions at this time.

Senator COCHRAN. Thank you very much, Mr. Dyhrkopp, for your statement.

I, too, want to extend my congratulations to Bill Henderson on being selected as our new Postmaster General. I have had an opportunity, as he mentioned, to meet with him and to talk about the Postal Service and some of its challenges and its accomplishments in recent years and what lies ahead. We look forward, as the Subcommittee with oversight of the Postal Service, to continue to work to help ensure that the Postal Service is able to carry out its obligations under the statute that created it.

The information that you gave us, Mr. Dyhrkopp, on the origin of the limitation on postal ratemaking or rate approval by the Postal Rate Commission was interesting, quoting from Section 403 of the Postal Reorganization Act of 1970.

I wonder if you know, what was the reason for the limitation of the jurisdiction of the Postal Rate Commission in this way to domestic postal rate approvals? It was a conscious decision, is what you're saying, an intentional act; it wasn't an oversight that international ratemaking was left out from the jurisdiction, was it?

Mr. DYHRKOPP. I am old enough to have been there when they did the changing, but I wasn't and I'm not familiar with it, but I will supply that information for the record.

Senator COCHRAN. Well, that would be helpful.

We think there is very little guidance about the legislative history in the debates or the discussions of the act. I was not a Member of Congress, either. Bill Henderson, were you working for—

Mr. HENDERSON. I was a diaper specialist at that time. [Laughter.]

Senator COCHRAN. You were not employed by the U.S. Postal Service at that time, were you?

Mr. HENDERSON. No, but I have some background.

Senator COCHRAN. What's your understanding of the origin of that?

Mr. HENDERSON. It's because it's primarily a deregulated market. There are no postal protections there; it's wide-open territory, so there was no reason to restrain the U.S. Postal Service from competing in that market.

Senator COCHRAN. Another thing that came out in your statements that was an interesting revelation to me—I'm new to this job, too, as Chairman of this Subcommittee with jurisdiction over the Postal Service—and that is the fact that a lot of the competition in the international mail area comes from foreign postal services of countries that you are competing with; not just U.S. businesses that are also engaged in the business of delivering things in the overseas market.

To what extent do these foreign postal service competitors share in that international market? Is there any way to quantify that?

Mr. HENDERSON. We don't have any numbers on how much mail they take out into Europe and other countries, but we will show you—there is a company called Royal Mail U.S., Inc., headquartered in New York. It is a subsidiary of Royal Mail, and it has an active office in New York, one in Chicago, and in California, where they are getting shippers.

This is an ad that says, "Metro Mail and Royal Mail have joined forces, so now you can mail Birmingham, England as easily as Birmingham, Alabama." It's an attempt to get major shippers in the United States to use them.

Here's another one that you might find of interest. In North America, Royal Mail sales exceeded 25 million pounds in 1997 and 1998, and by the year 2000 the aim is to secure 10 percent of the deregulated bulk mail market. It says, "Since the early 1990's, Royal Mail has been selling bulk mailing services to large international business mailers in continental Europe, the United States, and Canada."

Senator COCHRAN. For the information of the Subcommittee and others, is Royal Mail—is that Great Britain's mail?

Mr. HENDERSON. That's Great Britain's mail, yes.

The Dutch are here with an active element. In fact, the Dutch are here buying interest in mailing companies in the U.S. So it's very much an open international competition, and if we were to be regulated, we would be out of that market, because they are certainly not regulated.

So it's not just an issue of U.S. companies and U.S. Postal Service. It's truly a global situation.

Senator COCHRAN. Under the rules for setting and approving rates on domestic mail service you have a deliberate process that you follow for changing rates. Sometimes it takes up to 10 months; I think you mentioned that in your statement. In comparison to domestic rate changes, how often does the Postal Service currently change its international rates? And how would international rate-setting change if it was subject to the Postal Rate Commission's regulation?

Mr. HENDERSON. Well, you would completely lose your pricing flexibility. Just take a simple product. We have a shipping to Japan from L.L. Bean, and we have to adjust prices from time to time because the Japanese change their in-country rates. We wouldn't be able to do that if we were regulated as we are domestically. We would have no pricing flexibility, and without that, in a market that is completely unregulated and you're the only one regulated, you're just simply not competitive. We would just drop out as being one of the players. We don't think that's a good idea.

Senator COCHRAN. How does that work in practice? Would everybody peg their prices just below what your regulated price would permit you to charge?

Mr. HENDERSON. No. They would peg their prices based on their own efficiencies. That's why you have some people come in priced at different levels. We set our prices to cover our costs and a responsible markup. So I don't know what their costing situation is. We don't examine our competitors' costing or revenue numbers.

Senator COCHRAN. So in response to the question I asked about how often the Postal Service changes its international prices, is there any specific way to respond to that question?

Mr. HENDERSON. Well, I can go back for the record and show you. But really, it's a marketplace determination.

Senator COCHRAN. Is the Postal Service developing new rates for international mail at this time? And if you are, when do you anticipate that new international rates will be announced?

Mr. HENDERSON. I am not sure that we are. I don't know if today we are developing new international rates. I'd be happy to find that out for you.

Senator COCHRAN. Can the Postal Service show that domestic ratepayers are not cross-subsidizing international ratepayers?

Mr. HENDERSON. Yes.

Senator COCHRAN. How are you able to do that, if all we have is what you gave us in your opening statement? You gave us three numbers, the total gross numbers, and the net profit that you're making on international mail, the cost of international mail, and your revenues from international mail. But beyond that, do you have any other data or information about those numbers that will convince domestic ratepayers that they're not cross-subsidizing international ratepayers?

Mr. HENDERSON. Well, today we have a letter from Ernst and Young that was dated June 1, and I will submit this for the record.<sup>1</sup>

In the last paragraph it says, "In the context of the overall report, and recognizing the variability of estimates derived from the statistical systems for small categories, the international mail category, representing less than 2 percent of postal operations in aggregate, reflect a positive contribution in 1997, an indication based on the Postal Service's allocation and estimation process, that no aggregate cross-subsidy at the marginal or incremental cost level existed in 1997." This is from our outside auditors. In addition, I think the Inspector General's report, hopefully, will put to bed this issue once and for all.

Senator COCHRAN. Well, I think the Inspector General being requested to do what you have announced today is a very important step in the right direction to help put facts out in the public domain so that those who have made suggestions that you are in effect cross-subsidizing between international and domestic ratepayers will at least have their suspicions confirmed, or not. I think that is important for you to do and we thank you for that.

Senator Levin.

Senator LEVIN. Thank you, Mr. Chairman.

<sup>1</sup> The referenced letter appears in the Appendix on page 46.

On the Inspector General's report, when is that due?

Mr. HENDERSON. We have not set a timeframe. We asked her yesterday to do it, and we have to get back to her and see what kind of timeframe—

Senator LEVIN. Would you let us know what that timeframe is?

Mr. HENDERSON. Yes, I will.

Senator LEVIN. Going back to the decision to leave the rate-setting in international mail up to the Postal Service instead of the Postal Rate Commission, you were asked by the Chairman whether that was done intentionally, explicitly, or whether it was done by default—in effect, by silence, by not allocating that function to the Postal Rate Commission. And your answer was that there was no reason to restrain the Postal Service, or words to that effect, and I am a little unclear as to what you meant.

Looking at the legislative history—or remembering it, because I haven't looked at the legislative history—is it your recollection that there was an intentional, purposeful decision by the Congress to leave the rate-setting to the Postal Service? Or was there just silence, with no record?

Mr. HENDERSON. It's my understanding—I wasn't there—it's my understanding that that was the intention of Congress—

Senator LEVIN. The express intention?

Mr. HENDERSON. It was not an oversight.

Senator LEVIN. How many different international rates are there?

Mr. HENDERSON. There are approximately 10 products, and the products—the rates—will vary from country to country.

Senator LEVIN. So you have different rates for 10 different products?

Mr. HENDERSON. That's right.

Senator LEVIN. So there could be 100 different rates?

Mr. HENDERSON. That's right.

Senator LEVIN. Or 500 different rates, depending?

Mr. HENDERSON. It depends on how many products we have in each country, that's right.

Senator LEVIN. Do you change the rate for one product at a time?

Mr. HENDERSON. Yes, one customer—on the customized products, which have a certain volume requirement, we do change the rate from customer to customer. We publish the overall rate structure in the Federal Register, and we deviate from that based on the costs associated with that customer.

Senator LEVIN. So that a product is a packaging product, is that what you're saying?

Mr. HENDERSON. It's a bulk product, yes.

Senator LEVIN. Based on the shape or size?

Mr. HENDERSON. Based on volume, pieces and weights.

Senator LEVIN. So that different customers will get different rates for the same product?

Mr. HENDERSON. Based on the costs. For example, just as one example, the delivery costs—the delivery and entry costs—in different countries are different.

Senator LEVIN. No, I don't mean that. Would two different customers going to the same place in another country get different rates, depending on how much they send?

Mr. HENDERSON. Depending on how we bill their costs, how efficient they are. For example, some customers send mail to Japan in bulk; some customers pre-sort it for Japan. It is obviously more efficient for us if we don't have to do that sortation.

Senator LEVIN. Would a customer pre-sorting 100 pieces get a cheaper rate than a customer pre-sorting 50, possibly?

Mr. HENDERSON. Possibly.

Senator LEVIN. And those are negotiated rates?

Mr. HENDERSON. Negotiated rates, yes.

Senator LEVIN. Those are based on costs?

Mr. HENDERSON. Yes.

Senator LEVIN. Are they based on competition?

Mr. HENDERSON. No, just based on our costs and a reasonable margin.

Senator LEVIN. So you don't watch what your competitor is doing with a particular offering to a particular customer, and meet it?

Mr. HENDERSON. Our competitors don't tell us what their discounts are.

Senator LEVIN. But your customers might tell you what the offer was from a competitor.

Mr. HENDERSON. No, they don't do that.

Senator LEVIN. The Ernst and Young reference that you made, was that the audit that you referred to? That letter that you just read from, is that the same document as—I think Mr. Dyhrkopp said, "We now have the benefit of certification by an outside CPA firm." Is that the Ernst and Young reference?

Mr. HENDERSON. Yes.

Senator LEVIN. And is that audit available to us?

Mr. HENDERSON. Yes.

Senator LEVIN. And about how large a document is that? Is that a 10-page, 100-page audit?

Mr. HENDERSON. It's about this thick.

Senator LEVIN. All right. And does that have all their assumptions in it?

Mr. HENDERSON. Yes. Everything they reviewed is in there.

Senator LEVIN. Was there not a fear that you had that some of your data was proprietary and that you were afraid of disclosing that to a competitor?

Mr. HENDERSON. That's right.

Senator LEVIN. Is there any proprietary material in that audit which you would not want your competitors to know?

Mr. HENDERSON. No, there's no proprietary material in this audit.

Senator LEVIN. So whatever is in that audit is available to us and can be shared publicly?

Mr. HENDERSON. That's right.

Senator LEVIN. What is not in there that you don't want to share publicly? There has been some real debate over the years, I believe, with prior bills—literally, Senator Pryor— [Laughter.]

Senator LEVIN [continuing]. Who wished to have some kind of analysis of certain material on your costs, and that was apparently rejected because there was a fear that your competitors would see what certain costs were, certain other data.

Mr. HENDERSON. They would see what your pricing strategies and your marketing strategies are, and that kind of information is not shared among competitors. But we are going to turn over to the IG, who will keep the information proprietary, all of our international information, so that all those questions about cross-subsidy can be resolved.

Senator LEVIN. Cost strategy, and you said pricing strategy?

Mr. HENDERSON. Pricing strategy.

Senator LEVIN. What was the other strategy?

Mr. HENDERSON. Market strategy.

Senator LEVIN. Market strategy.

The pricing strategy is your cost plus a reasonable—

Mr. HENDERSON. That's right.

Senator LEVIN. That doesn't sound too complicated.

Mr. HENDERSON. It's not too complicated, but it is competitive.

Senator LEVIN. But it doesn't sound very private. What is in there that we're missing here?

Mr. HENDERSON. Well, how much the markup is by competitors is not available to us. We have no idea what their markups are.

Senator LEVIN. No, I'm talking about what is in your strategy that you don't want to make available to others. I thought your strategy was to take your cost and add a markup.

Mr. HENDERSON. That's right, build our costs from the bottom and add a reasonable margin to the markup.

Senator LEVIN. But what those costs are that you don't want to be—

Mr. HENDERSON. That's right, and we would not like to have our margins in our competitors' hands, also.

Senator LEVIN. All right. And what those costs are is not in that audit, right?

Mr. HENDERSON. No, that's right.

Senator LEVIN. And your marketing strategy is not in that audit, either?

Mr. HENDERSON. That's correct.

Senator LEVIN. All right.

One last question. How would someone who is skeptical—not me, but anyone who is skeptical—how would a skeptic know that the costs that you gave to your auditor are—these are guesstimates, I take it? You are making estimates of costs; you can't have actual, precise costs? You have to attribute certain costs to certain activities, I assume. How would a skeptic know that the attributed costs are in fact fairly apportioned costs unless they could be reviewed by someone outside of the Postal Service, or an independent auditor? Because you're giving that auditor the attributed costs, I assume, aren't you?

Mr. HENDERSON. Yes. Well, I think that's a valid issue. We don't want, year after year, to come up and defend what looks like the fox counting the hens, so we are willing to turn over to the Inspector General all of our costing data. That's a very independent view of the Postal Service, and they can validate the fact that we are not cross-subsidizing, and that's what we intend to do.

Senator LEVIN. But the outside auditor was just given costs that you attribute to the particular function, is that correct?

Mr. HENDERSON. Yes, that's right. But the international attribution is similar, very similar, to the domestic attribution, and the domestic attribution is under the full scrutiny of the Postal Rate Commission.

Senator LEVIN. Thank you, Mr. Chairman.

Senator COCHRAN. Let me ask a couple more questions, Mr. Henderson—oh, excuse me, Senator Cleland?

Senator CLELAND. That's all right.

Senator COCHRAN. It's your turn.

Senator CLELAND. Mr. Chairman, thank you.

Mr. Henderson, thank you very much. Your wonderful people in Georgia do a great job there and we thank you very much for you and all your employees in the tough job that you have to do, in rain and snow and sleet and dark of night.

Let me ask you, would you consider the Postal Service itself as a subsidized entity in this country?

Mr. HENDERSON. No, sir, I would not. We get all of our revenues from stamps.

Senator CLELAND. But you don't pay taxes, do you?

Mr. HENDERSON. No.

Senator CLELAND. That looks a little bit like a subsidy to me. I just thought I would throw that out. I'm not complaining about it, but I just thought that you get a tax break, so to speak, where other people don't who are in the same business.

Do you have any competitors here in terms of your domestic market? Are there other people out there trying to do what you do in the domestic market in which you find yourselves?

Mr. HENDERSON. There are people that do what we do, yes, but in kind of a practical sense—in the package delivery business, our domestic competitors are primarily in a business-to-business competition, and we're primarily focused on residential delivery. So while we talk about the fact that we are competitors, they are really focused on a business-to-business entity.

We provide a universal service. We go to everyone's household every day. That accounts for some of our governmental status. We're there in rural areas where there aren't other people. We go to places where it's not cost-effective to go out there and deliver mail.

So we are a different entity. We are a quasi-government agency that is supposed to be run in a businesslike fashion, and that's what we're trying to do. I think our improved service of the last 4 years has raised the eyebrows of some of our competitors. For 22 years in my experience in the Postal Service, Federal Express and UPS rarely ever mentioned our name. Now that our service levels are up and our customers are saying, "Hey, the Postal Service might be an alternative," we are now getting on the radar screen.

Senator CLELAND. But as a quasi-governmental entity, I'm just really trying to understand the basis of your authorization here in 1970. It is a quasi-governmental agency, which is why we're here before a governmental entity, and you don't pay taxes. You are, in effect, a quasi entity, and it does seem to me you are somewhat subsidized by the American taxpayer. I find it interesting that you don't feel that. Is that correct?

Mr. HENDERSON. We get our revenues—when you talk of subsidy, it's money—we get our money, except for postage for the blind and franking privileges of Congress, we get our money from our stamps. We provide a service, and not in all instances for profit. We are a quasi-government institution.

Senator CLELAND. That's another thing, too, that you don't have to make a profit. You don't pay taxes and you don't have to make a profit.

What percent of your business is international in this market that you're out there wheeling and dealing and competing for as another business? What percentage of your total business is that?

Mr. HENDERSON. It's less than 2 percent.

Senator CLELAND. I find it interesting that you say that if you came under the Postal Rate Commission, that then you would go out of business in the international market. You would lose 2 percent of your business?

Mr. HENDERSON. We would not be a competitor if we were under the Postal Rate Commission and the domestic rules. We simply wouldn't have pricing flexibility.

Senator CLELAND. I find it fascinating. I know it takes a long time, and you mentioned 10 months, but I find it hard to believe that you would just go out of business in the international market. It seems to me that if you had a good justification and a good argument, you could make your case before the Postal Rate Commission and that they would understand the pressure of competition in the international market.

Mr. HENDERSON. The domestic rules of the Postal Rate Commission would not allow us to have customized agreements with customers the way we do. That is simply not possible in the current legislative framework.

Senator CLELAND. Well, I think you make a point there. That's something our staffers may want to consider in the bill in terms of making legislation possible.

But I just thought I'd ask what percent of your market was international, and you said 2 percent.

Correct me if I'm wrong; I may have bad information here. The Postal Service does delivery between Waycross, Georgia and Atlanta, Georgia, and Waycross, Georgia and London. Do I understand correctly that it's cheaper to send something from Waycross, Georgia to London than it is from Waycross, Georgia to Atlanta? Is that correct?

Mr. HENDERSON. No. I'm not—if you're talking about the comparison that's been in the media, if you took a 10-pound package and mailed it across the United States, Express Mail, it would be around \$30. If you mailed it Express Mail—in other words, the same service—to London, you're talking about \$53. So it's not cheaper. That comparison was made with Global Package Link, which requires a customer to mail 10,000 pieces over a year's period. But each mailing must be a minimum of 200 pieces or 50 pounds, and it's an electronic manifest. There's no postage. A single piece, you have to go to a counter, it's weighed, it's handled by a clerk—all of that work is taken away in our Global Package Link. So it's really comparing apples to oranges.

Senator CLELAND. What is Global Package Link?

Mr. HENDERSON. It's a service that we provide to large mailers in the United States who want to get into foreign markets. It's a bulk package service.

Senator CLELAND. And you are able to provide that service, say, to London much cheaper than any other private domestic company can?

Mr. HENDERSON. No, I don't think we can deliver it cheaper than any other private delivery company. You'd have to ask the customers that.

Senator CLELAND. Well, I find it fascinating that you mention that it would take 10 months to get a decision from that governmental entity. What is the holdup in terms of time, knowing that time is something that is sensitive to you?

Mr. HENDERSON. That's the statute itself.

Senator CLELAND. The statute says it takes 10 months?

Mr. HENDERSON. That's the process in the statute.

Senator CLELAND. The process takes 10 months?

Mr. HENDERSON. Yes.

Senator CLELAND. Why does the process take 10 months?

Mr. HENDERSON. Because it's a full, open hearing for all of the people who are interested in looking at your costs and your revenues to examine those. If it were international, it would be foreign administrations, U.S. businesses and foreign businesses, and it takes that long for the procedures.

Senator CLELAND. But you are a regulated entity; 98 percent of your whole, entire work is a regulated entity, and 2 percent is unregulated. I find it fascinating that you live in a totally regulated environment as a quasi-government entity, don't pay any taxes, don't have to make a profit, and yet for 2 percent more you fight any extension of that process to flesh it out for customers, consumers, and the government. I just find that fascinating.

But thank you for coming. My staff dug up something. We didn't know that Royal Mail was going to be mentioned here at all, I guarantee you, so this is not foresight here, but looking back at the evolution of the Postal Service you mentioned Royal Mail, so I'll mention this. The staff dug it up. Actually, royalty did have a hegemony on postal service until 1635, when the King of England decided that the average person should have that privilege too, so Royal Mail was begun a long time before our mail.

But I understand your point about competition. We'll take that under advisement. Thank you very much.

Thank you, Mr. Chairman.

Senator COCHRAN. Thank you very much, Senator.

Mr. Henderson, in its Five Year Strategic Plan for 1998 to 2002, the Postal Service includes the goal to improve customer satisfaction and to provide timely delivery, with indicators of targets for on-time delivery of first class domestic mail. Has the Postal Service set goals with similar indicators to evaluate international business? And if so, what are they?

Mr. HENDERSON. We have set goals with individual countries on delivery of the mail. We also get feedback from individual customers on how we're performing on our customized products. They have their own feedback processes, and they are very quick to tell us if we're not meeting their expectations.

Senator COCHRAN. Do you have delivery standards for international outbound mail similar to delivery standards for domestic mail?

Mr. HENDERSON. Yes, we do. We have delivery standards with foreign postal administrations that we meet on and agree to, and that's for your average person's mailing overseas. For individual large mailers, we reach agreements on acceptable service standards with that mailer on how quickly they want their product in that country and whether we can do it within that timeframe.

Senator COCHRAN. Does the Postal Service have a system of measurements in place to measure performance for international outbound products? And if so, how are these results reported?

Mr. HENDERSON. We have a system with Price Waterhouse, and they are shared among postal administrations throughout the world.

Senator COCHRAN. In June of 1995 the Postal Service embarked on an experiment by creating a strategic business unit, the International Business Unit, the so-called "IBU," to focus on the international market. The IBU developed a strategy to regain market share. I am interested in knowing how successful this strategy has been and whether the IBU concept has succeeded in meeting its goals.

Mr. HENDERSON. The IBU concept is in the very early stages, and I'd say that as a fledgling organization, its prospects look very good. It has thus far met its goals, which are not overly ambitious, but we hope to be more ambitious with those goals in the future.

Senator COCHRAN. Some competitors say that the Postal Service benefits through exclusive access to foreign postal administrations as the sole representative of the U.S. Government in the Universal Postal Union, which you have discussed. On the other hand, the Postal Service says it is burdened by its obligations as a member of the UPU.

Has the Postal Service conducted any studies to estimate the costs of meeting its obligations as a member of the UPU? And if so, could you provide us the results of those studies?

Mr. HENDERSON. I'm not aware that we've done any studies, but if we have, we'll provide them.

Senator COCHRAN. Has the Postal Service conducted any studies to estimate the cost of providing universal mail service on an international basis? If so, could you provide us the results of that study?

Mr. HENDERSON. Again, I'm not aware of any, but if we have done any, we will provide them.

Senator COCHRAN. A proposal to allow private operator associations and other stakeholders to participate in UPU functions on a limited basis is under consideration, I'm told. Would the U.S. Postal Service support this proposal?

Mr. HENDERSON. No, we will not. The UPU consists essentially of foreign postal administrations. We do business as one quasi-government entity to another national postal administration. We don't think it would be appropriate to put a private sector entity into that equation.

Senator COCHRAN. Mr. Dyhrkopp, you mentioned some of the ideas of the Postal Board of Governors on this issue of regulating international activities of the Postal Service. What role, if any, do

you think the Postal Rate Commission could properly play—or the Board of Governors properly play—in reviewing Postal Service competitive activities to ensure fair competition?

Mr. DYHRKOPP. The way it is structured now and the way it works—by the way, getting back to your question about 1970 and the new law, did they forget to do anything about the international part of it, or did they let it fall through the cracks or what—I don't know, but there is one thing I want you fellows to think about. If you read that law, it was very well done. It was made up to take politics out of the Postal Service, and also make the Postal Service self-supporting. The Congressmen and the Senators who were involved with working on it did a very good job. We have a good Postal Service. There is no country in the world where you can send a letter from San Juan, Puerto Rico to Nome, Alaska for \$0.32, or out to Guam. If we tinker with this thing, we could really hurt it.

I've been on the Board 4 years, and one of the things that I hear all the time from competitors is that we need a level playing field. Well, I can tell you, if we level that playing field much more we're not going to have a Postal Service. So you have to be very careful about this.

The Board takes its responsibilities very seriously. We ask for all kinds of information; we demand it; we have it checked; we have auditors and consultants come in. We don't just take the administration's answers without a lot of investigation on it. And when we feel like it's OK, that's fine; we'll pass it and let it go. We don't send you anything that we don't look at very, very carefully.

Senator COCHRAN. Some have suggested that if the Postal Rate Commission were given more authority over international postal rates, it would harm the Postal Service's ability to compete internationally, and therefore damage the mailers' ability to compete in the international marketplace. Is that a legitimate concern, in your opinion?

Mr. DYHRKOPP. I think that if you operate with the Postal Rate Commission on international mail, you're going to have to, somehow or another, get all the international carriers involved under regulation. You're going to have all the various countries that are going to have to be involved in some way, and I don't know how. But it would really be a monumental job to try to do it and to make it work.

We keep worrying about the Postal Service not having enough regulation. I think we ought to put some of the competitors under some sort of regulations to see how their figures all work out. But it would be very difficult when you are on a worldwide basis, a global basis, to make that work because you have so many foreign countries and other people involved.

Senator COCHRAN. Some figures that have been brought to our attention indicate that the Postal Service's overall revenue increased for the last fiscal year, 1997, by \$1.7 billion, while international revenues actually decreased by approximately \$27 million; and at present, international mail constitutes less than 3 percent of overall mail volume. I think Mr. Henderson mentioned that.

Considering these figures, how significant is the contribution to overhead costs that international mail makes in the context of holding down the cost of providing universal services?

Mr. DYHRKOPP. Well, at the present time, like you said, it doesn't contribute a great deal. But we intend to pursue this market, and we're hoping that it will add quite a bit to it. It will help us keep our domestic rates down.

We're just more or less really getting involved in it. It's going to be a slow process to work it out.

Senator COCHRAN. So the fact is that international mail's share of the overhead cost contribution has significantly decreased over the last several years, is that right?

Mr. DYHRKOPP. Well, if you take it over the whole, it's not really that much. If you pick out 1 year, there might be a little difference in it. But it's really a fledgling business. We started promoting it 3 or 4 years ago, and we're just getting it going. I think it has a bright future, but it's like any other new business. You have some rough spots in getting everything working right.

Mr. HENDERSON. To give you the actual numbers, in 1996 there was a \$360 million contribution; in 1997, a \$273 million contribution. You are correct, there is some erosion going on in just pure letter mail that is going overseas. The electronic erosion is having an impact on the Postal Service, that's accurate.

Senator COCHRAN. Mr. Dyhrkopp, there is some question about the accuracy of the cost system, the system for ascertaining costs of providing mail services by the Postal Service. Do you feel that the Postal Service subjects its review of its costs and its evaluation of its costs in a correct way? Would these pass a reliability test? And are you satisfied that the Postal Service is costing its international products accurately?

Mr. DYHRKOPP. Yes. The Board has to approve all of these reports and all of the functions that they do, and of course costing has to be finally approved by the Board. And if we didn't feel very comfortable with it, believe me, we would really be going into it.

We have our own auditors, Ernst and Young. They audit the whole Postal Service. We have the Inspection Service which does a lot of auditing. Now we have the Inspector General, which is totally separated from the Postal Service except that they report to the Governors, and it's a very important tool to the Governors.

If these figures weren't right, somebody is going to tell us about them, and I can guarantee you we'll do something about it.

Senator COCHRAN. Senator Levin.

Senator LEVIN. Thank you, Mr. Chairman. Just a couple questions.

What is your estimate of the percentage of international mail which you carry? Just a rough estimate.

Mr. HENDERSON. Of total mail?

Senator LEVIN. In other words, you said that 2 percent of your business is international.

Mr. HENDERSON. Right.

Senator LEVIN. That's not my question. My question is, what percentage of the total international mail is carried by the Postal Service?

Mr. HENDERSON. I don't have that information.

Senator LEVIN. Do you think you carry more than any other entity?

Mr. HENDERSON. Oh, no. We are a fledgling business.

Senator LEVIN. Would it be a small percentage?

Mr. HENDERSON. We're a smaller player, yes. To give you an example, Global Package Link, which is the focus of a lot of attention, is around a \$33 million product. UPS, for example, has a \$2.9 billion enterprise, so we are very small.

Senator LEVIN. Is that \$2.9 billion internationally?

Mr. HENDERSON. Yes. So we are a very small player in that.

Senator LEVIN. On the universal service that you made reference to, and the fact that you're a member of the UPU, are there any private sector entities in other countries that participate in the Postal Union?

Mr. HENDERSON. None to my knowledge.

Senator LEVIN. Is there any private company that takes on the same universal mail service commitment that you have, or obligation that you have?

Mr. HENDERSON. Yes. There are several European countries that take on universal obligations—

Senator LEVIN. No, I mean here. Are there any private companies here that match your obligation by taking, voluntarily, a commitment to do that?

Mr. HENDERSON. No, sir, none.

Senator LEVIN. We're talking about internationally, just on the international side, right?

Mr. HENDERSON. Restate the question, please, I'm sorry.

Senator LEVIN. You have universal service internationally?

Mr. HENDERSON. Yes.

Senator LEVIN. Does any private company in the United States voluntarily take on that same responsibility?

Mr. HENDERSON. Not to my knowledge.

Senator LEVIN. There are three reasons that you gave for why the Postal Rate Commission could not do this function. One was speed, the second was flexibility, and I think the third was confidentiality, as I analyzed the testimony.

Those seem all to come back to statute, one way or another.

Mr. HENDERSON. They come back to pricing flexibility.

Senator LEVIN. Yes, but you say that on the pricing flexibility, you might be able to be given that by statute.

Mr. HENDERSON. I hadn't thought of that, but that's possible.

Senator LEVIN. With the Postal Rate Commission setting certain parameters, with flexibility within those parameters?

Mr. HENDERSON. Well, the Postal Rate Commission oversight of our pricing simply wouldn't allow us to remain competitive in the marketplace.

Senator LEVIN. You're saying there's no way that we could design amendments to current law which would have the pricing, or the postage, set by the Postal Rate Commission, but in a way which gives you the opportunity to move quickly, flexibly, and with confidentiality?

Mr. HENDERSON. No, I wouldn't say that. There might be. It's just that we haven't seen one yet, but I wouldn't shut the door on that.

Senator LEVIN. Thank you.

Thank you, Mr. Chairman.

Senator COCHRAN. Senator Cleland.

Senator CLELAND. Thank you very much, Mr. Chairman.

Mr. Henderson, thank you all very much for being with us. Just one question.

When do you think the Inspector General report will be completed and we will have some data that we can look at?

Mr. HENDERSON. I don't have a date, but I promised the Chairman that I would get a date and get it back to you as quickly as I could.

Senator CLELAND. Before the end of the year, maybe?

Mr. HENDERSON. I would hope.

Senator CLELAND. Thank you very much.

Thank you, Mr. Chairman.

Senator COCHRAN. Thank you, Senator.

Thank you very much, Mr. Henderson and Mr. Dyhrkopp, for your assistance to the Subcommittee at this hearing. We appreciate it very much.

We will now have our second panel of witnesses come forward, please: Christopher McCormick, with L.L. Bean, Inc., Fred Smith, Chairman of FDX Corporation, and James P. Kelly, CEO of United Parcel Service.

We appreciate very much the attendance of all of our witnesses, and we thank you especially for providing the Subcommittee copies of your statements, which we will have printed in the record in full. We would encourage you to make whatever summary comments—or reading of your statement if you choose to do that—that you think might be helpful to the Subcommittee.

Let's start with Mr. McCormick of L.L. Bean. You may proceed.

**STATEMENT OF CHRISTOPHER J. McCORMICK,<sup>1</sup> SENIOR VICE PRESIDENT OF ADVERTISING AND DIRECT MARKETING, L.L. BEAN, INC.**

Mr. McCORMICK. Thank you, Chairman Cochran, Members of the Subcommittee. My name is Christopher McCormick. I am Senior Vice President of Advertising and Direct Marketing for L.L. Bean. I appreciate the opportunity to appear before you today to address concerns that we have with S. 2082 and its impact on customers of the U.S. Postal Service's Global Package Link service.

L.L. Bean is the largest outdoor specialty catalog marketer in the United States. We are located in Freeport, Maine, where the company was founded 86 years ago. Our 1997 sales exceeded \$1.1 billion to customers in the United States and in over 150 countries worldwide. Approximately 10 percent of our revenue is derived from international sales, with our Japanese business constituting about 90 percent of that revenue.

A key to competitiveness for direct marketing businesses is the availability of high quality and low cost parcel shipping and catalog delivery services. For L.L. Bean, these costs constitute over \$100 million annually. More than \$40 million is related to delivery costs for catalogs and other forms of customer communications. The remainder represents costs for domestic and international package shipping and delivery. The success of our business is highly de-

<sup>1</sup> The prepared statement of Mr. McCormick appears in the Appendix on page 59.

pendent upon effective partnerships with the USPS and commercial parcel shippers.

Fortunately, the U.S. market is well served by high quality and competitive commercial shippers, including those represented here today—FedEx and UPS, as well as a national Postal Service with a dedication and commitment to its customers.

L.L. Bean has enjoyed excellent relations with each of these organizations over the years. FedEx is today our preferred carrier for our domestic package delivery. Both the Postal Service and UPS have handled this business in the past. USPS, through Global Package Link, services our Japanese parcel and catalog delivery needs and, of course, delivers our domestic catalogs.

In sum, L.L. Bean, the direct marketing industry, and in turn the Nation as a whole, are well served by these quality companies and worthy competitors.

L.L. Bean believes that careful deliberation and extreme caution are called for in any changes contemplated by Congress that might affect the competitive playing field in the parcel delivery industry. In L.L. Bean's experience, healthy competition in the industry has been the impetus for service innovations, improved customer focus, and lower costs. Particular customer needs—or market niches—are best served by different companies at varying points in time, and individual company strengths and their competitive edges evolve and change over time.

By way of illustration, I would point to L.L. Bean's experience in our relationship with FedEx for domestic package delivery. In 1993, FedEx developed an exclusive package delivery service for L.L. Bean. This new service made available superior tracking and tracing capabilities that allow our customers to know the status of orders en route to delivery. We were able to implement this new service while holding the line on costs and reducing delivery times. Today, an equivalent level of service is broadly available in the market and serves as the standard for domestic package delivery.

Similarly, in 1994 L.L. Bean identified a need for a breakthrough in costs and quality of service for our international customers. This need was driven by our growing business in Japan. Customer research told us that we could not sustain or grow this business over time without major modifications to existing practices. The most significant issue the research identified was the need to reduce shipping charges and delivery times.

To place this issue into context, L.L. Bean has traditionally served our international customers through a cross-border mail order business model. We accept orders through the phone, mail or fax at our Freeport location and ship packages from Freeport to our international customers. As our Japanese business experienced more rapid growth, we chose to serve this market through the existing business approach, with additional service enhancements. This business model allows L.L. Bean to leverage our customer service, order fulfillment capacities, and talented workforce in Maine as opposed to investing in in-country facilities and labor.

From a U.S. trade perspective, this approach allows companies to operate in foreign markets from a domestic base, thereby contributing to the health of the U.S. economy by generating domestic investments and jobs. However, for this approach to succeed, the

costs of package delivery represent a substantial barrier to be overcome.

The USPS responded to our needs for lower costs and reduced shipping times with their proposal in 1994 to handle our business to Japan through Global Package Link. We chose the USPS proposal over five others received through a competitive review process. The GPL offering reduced our 1994 delivery costs per package by approximately 50 percent, while reducing delivery times from two to 3 weeks down to 5 to 7 days. The USPS offering also met the critical test for universal service to all households in Japan.

While the details of the competing proposals are protected by confidentiality agreements, I can tell you that the costs varied widely. One carrier's proposal was very close in price to USPS, while the others ranged from two-thirds higher to more than double the GPL offering. All carriers were able to meet our delivery time standard, but the Postal Service product provided the greatest certainty of universal household service within Japan.

GPL has worked well for L.L. Bean over the 3 years it has been in place. Indeed, it has become vital to the continued existence of our cross-border mail order business in Japan. This business experienced rapid growth in the early 1990's at a time in which our catalog was a unique offering to Japanese consumers, and the dollar-yen relationship was most favorable to mail order products priced in U.S. dollars. Since 1994 the change in the exchange rate has caused our products to experience a relative price increase of over 50 percent as compared to goods priced in yen.

Additionally, L.L. Bean catalogs are no longer unique to Japanese consumers. The Japanese consumer now has an unlimited choice of mail order offerings from U.S. and Japanese mail order companies and from a wide array of worldwide mail order competitors. Many of these competitors have chosen to serve this market by investing in in-country facilities and capacity, including several well-known U.S. companies. Naturally, catalog businesses with in-country facilities have shipping cost advantage, and catalog customers in Japan are becoming increasingly sensitized to shipping rates.

Not surprisingly, our customer research bears out this heightened consumer sensitivity to catalog shipping charges. "Have to pay too much for delivery" is the most cited problem with 48 percent of respondents in a recent customer survey identifying this as an issue; 16 percent of those customers indicated that they were "likely to not" purchase from L.L. Bean due to this issue; and a full 68 percent indicated that they "may not" repurchase.

From these findings, we estimate that the high cost of shipping may cost L.L. Bean from \$3.6 million to \$15.1 million in 1998 sales.

It is clear that existing catalog customers in Japan are dissatisfied with the current cost of shipping from the United States to Japan. Not reducing existing rates will cause significant market loss. Increased shipping rates would jeopardize the existence of L.L. Bean's direct sales to Japan and our international business unit.

While this business has been impacted by other factors, including the unfavorable dollar-yen relationship, increased competition and the overall decline of the Japanese economy, shipping charges re-

main the most vital factor to keep companies like ours in the business of cross-border mail order shipping. I am sure that other customers of the Postal Service's GPL service can describe similar impacts on their businesses in Japan as well as other countries.

The struggle between the Postal Service and the commercial parcel shippers over the Postal Service's role in international shipping has implications well beyond which competitor obtains this business. Given the extreme sensitivity of mail order customers to shipping charges, the outcome of the current struggle could determine whether this form of direct foreign sales survives and grows or slows to a trickle.

There are two alternatives to its survival. One is the further movement of United States direct marketers away from serving foreign customers from a domestic base, toward an in-country business model. This may require significant capital investment, an investment that could have been made in the domestic market.

The other alternative is for U.S. companies to abandon the business to global competitors that are able to effectively address the shipping cost issue through more cost-effective postal or commercial carrier arrangements available through their host countries. This would represent not only a loss to U.S. mail order firms but to the economy as a whole through erosion of domestic jobs and investment.

I am aware of the variety of issues and challenges the competitors of the Postal Service have raised to the continued role of the Postal Service in serving the international package delivery market. I would not claim that L.L. Bean as a customer of the Postal Service is qualified to independently examine in depth each of these claims. We have, however, participated in a General Accounting Office review of some of the issues; this study is due out shortly.

We are also aware of the specific claims that gave rise to the amendment you are considering here today, i.e., that the GPL service is cross-subsidized by monopoly mail, thereby allowing the Postal Service an unfair competitive advantage.

Again, we are not privy to the USPS cost justifications for the prices they charge, but we have reviewed this question with Postal Service officials. We have been assured that this service is not cross-subsidized and cannot be cross-subsidized under existing law.

We look forward to the day that mail order companies have a viable choice of shippers to service our international customers, at a price that will allow our business to survive and prosper. We are confident that this choice will emerge as it has in the domestic market, but urge careful thought and cautious action on the part of Congress in intervening in a way that disrupts the current balance among strong, healthy and vigorous competitors in the package delivery business.

Thank you for allowing me to address this Subcommittee. I would be happy to answer any questions you may have.

Senator COCHRAN. Thank you, Mr. McCormick, very much.

Fred Smith, Chairman and CEO of FDX Corporation, we welcome you and you may proceed.

**STATEMENT OF FRED SMITH,<sup>1</sup> CHAIRMAN AND CHIEF  
EXECUTIVE OFFICER, FDX CORPORATION**

Mr. SMITH. Thank you, Mr. Chairman, on behalf of the 170,000 folks that make up the FDX team through our operating subsidiaries, and in particular Federal Express and RPS. We have a significant interest in this legislation and we are very grateful for being included on this panel. We have submitted written testimony, and if I could, I would like to just try to paint a slightly broader picture here, if I might.

Let me reiterate on the front end that we strongly support this legislation, although we feel there are a couple other points that should be added into it, and in fact we urge a much broader reform of the postal issue to be taken up by the Congress.

I think part of the problem that we have here, listening to the testimony that has gone before, is that we're talking about specific issues which are created by a much, much larger mosaic. A little history is in order here.

The Congress gave the Post Office, the predecessor to the USPS, a monopoly in 1871 to deliver letters, and that's all that the Congress gave them a monopoly on. They didn't give them the monopoly on moving packages or express or selling goods or any other thing; it was moving letters. And for well over a hundred years, the Postal Service—in many, many different fora, mostly judicial—attempted to expand the common sense and the common law definition of what a letter was. In fact, one of the most famous of those was a Postal Service lawyer in a court case, when pressed as to whether a political bumper sticker like you might use in your election was a letter, he stated that it was; and then he was asked if there were any conditions under which it might not be a letter, and he said, well, he guessed if it was stuck to a bumper, then it might not be a letter any more.

But the Postal Service over and over again attempted to expand this definition of a letter to include football tickets and abstracts and surveys and prospectuses and so forth, in order to protect that monopoly franchise. And of course, in the legislation in 1970, the USPS took over, and not too long after that technology and change began to modify the landscape.

What's been going on since that time, and with an increasing urgency on the part of the Postal Service, would be called in the private sector an effort to diversify, because the Postal Service can see that its monopoly revenue stream of moving letters is subject to electronic diversion to E-mail, facsimile, and on the horizon, a great deal of invoices and check remittances are likely to be moved electronically, as well.

After that recognition dawned on just about everybody—and there's a good example of that that was discussed here today, when they were talking about how postal revenues internationally are down. Well, the reason they're down is that it takes a long time to send a letter internationally, and facsimile takes not very much time at all; and if you look at the statistics of the big telephone companies today, almost 30 percent of their foreign circuits are taken up moving faxes, not taken up moving voice. And even great-

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<sup>1</sup> The prepared statement of Mr. Smith appears in the Appendix on page 61.

er, as WorldCom down in Jackson, Mississippi is finding, moving data over the Internet.

So with that recognition, you had this effort on the part of the Postal Service to diversify, which is what you would call it in the business world. They have a renewed interest in the package delivery business after having, in essence, ceded that business through very good competition represented by UPS and, to a lesser degree, ourselves in years past. And the facts of the matter are that the Postal Service's letter monopoly gives it a huge advantage in engaging in all types of commercial activities in which it would otherwise not be competitive.

I forgot to bring today my tie that I bought at the Postal Service a week or so ago to demonstrate this point. It's a Bugs Bunny, Daffy Duck, and my favorite, Tasmanian Devil tie. It was sold at the Postal Service—actually, it was sold in Mississippi; it was bought by one of our fellows. No tax paid on it. I wonder if our good friends at L.L. Bean would be as interested in the Postal Service cross-subsidizing things once they decide they want to start selling those ties and other merchandise by mail, because what's the difference in terms of vertical integration?

And the Postal Service, for instance in the case of global mail, they cited in their testimony that they have \$1.6 billion or \$1.7 billion in revenue, and they have a \$200 million surplus in that. Well, the vast majority of those revenues, as the Postmaster General pointed out, don't come from moving Global Package Link; they come from moving first class mail. And then they sort of layer on top of that services which by any commercial account would be significantly below cost, and certainly below the cost were it provided in the commercial marketplace, absent that cross-subsidization of the U.S. mail.

So when you cut through all of these issues, what the Congress really has to decide is, does it want to have a company, which it set up with a monopoly to move first class letters—which a lot of people would debate with you today, why the people in McLean, Virginia, sending letters to Potomac, Maryland, are subsidizing moving a letter from Puerto Rico to Guam, but I guess we'll take that up another day but that was a big deal in 1871 before they had E-mail and fax and FedEx and UPS. And by the way, we both serve every address in the 48 lower States, Hawaii, and Puerto Rico. The only place we don't serve every place is Alaska. We don't go there every day, but you ship something to any address in the United States, UPS and FedEx will deliver.

So we strongly believe that the Postal Service's efforts at diversification should be put in an appropriate context. There is a bill over on the House side which does that, which we strongly support, and we support your bill, Mr. Chairman, on establishing this oversight of the Postal Rate Commission on this international side.

There are two other things we think are urgent and which need to be done, however. The second initiative is to get the Postal Service, which is now a commercial business in many respects—we need another Executive Branch agency representing the United States at the Universal Postal Union, because you have the Postal Service as the representative of the United States, and then you

have a representative of the Postal Service as the representative of the U.S. Postal Service, Inc.

And the third thing is that the Postal Service needs to be subjected to the same customs regulations as FedEx and UPS and the other private carriers do. One of the biggest advantages that they were able to offer L.L. Bean, which were unable to be offered in the commercial sector, is that if you ship something by Postal Service, that's the customs declaration you have to use, right there, that one little bitty green thing right there. The Postal Service has no legal responsibility whatsoever for what you're shipping or the declaration that you're making to the inbound customs service. And the reason for those delays that L.L. Bean was experiencing on the commercial side in those days, the customs service held up everything that came in on the private carriers; things that went by the Postal Service went right through because of that little green declaration. That's an example of the manifests that FedEx has to send on one of our international shipments, with every possible detail about that shipment, and we are responsible to the customs authorities, not the shippers, in the event that there is contraband, drugs, or explosives in that shipment.

So we would urge you to press forward with this legislation, Mr. Chairman, but add into it the requirement that the Executive Branch be represented by another entity—USTR, Department of Commerce, or whomever. And then third, that the customs requirements that apply to private carriers also be applied to the Postal Service because it's in the national interest for that to be the case.

The last thing I will say, Mr. Chairman, is one of the things we at FedEx find most offensive about what the Postal Service is doing—again, we don't begrudge them doing anything; we're perfectly happy to compete with them, we're perfectly happy for them to be in any kind of business they want, provided that in that competitive sector they have to apply the same overhead to the competitive services that they did to the monopoly services, that they're subject to the same regulations, like OSHA, that they're subject to the same requirement to pay their fair share of taxes—they don't pay a dime of it; they don't even buy license plates.

And most importantly, that they be subject to the same laws as we are. We sued the Postal Service over their advertising campaign. We subjected the Postal Service's advertising campaign on Priority Mail to our lawyers and said, "Could we run that advertising campaign if we had a service like Priority Mail?" Our lawyers told us that if we conducted an advertising campaign like that, we'd get the bejesus sued out of us. It's misleading and it's false and it's not right, because their defense in being able to do that is that they are exempt from the same rules that apply to L.L. Bean or UPS or FedEx in terms of advertising. So they can't have it both ways. They can't be a government agency when it's convenient to be a government agency, and a private company when it's convenient to be a private company. This shibboleth about you're going to bring into jeopardy the \$0.32 stamp from Guam to Puerto Rico is a convenient scare tactic to defuse what's really at issue here, and it is a massive effort on a government-sanctioned monopoly to diversify into services which are provided by the private sector, with

all that implies—taxes and the other benefits that private enterprise brings to this country.

So we support the legislation and we very much appreciate the opportunity to make these comments before you.

Senator COCHRAN. Thank you, Mr. Smith, very much for your assistance to our Subcommittee.

Our final witness is James P. Kelly, Chairman and CEO of United Parcel Service.

Mr. Kelly, you may proceed.

**STATEMENT OF JAMES P. KELLY,<sup>1</sup> CHAIRMAN AND CEO,  
UNITED PARCEL SERVICE**

Mr. KELLY. Good afternoon, Mr. Chairman and Members of the Subcommittee. I am Jim Kelly, and I am Chairman and CEO of United Parcel Service. I appreciate the opportunity to discuss a topic that is important to me, our company, and the 330,000 people we employ worldwide.

The need for meaningful reform of the U.S. Postal Service has never been more clear or more timely. I applaud your efforts here in this Subcommittee and commend your colleagues in the House, who are also working diligently to examine the role of the Postal Service in today's competitive marketplace.

We fully support this legislation. The proposal addresses a serious problem, the fact that the Postal Rate Commission currently has no oversight authority on international postal rates and services. In effect, the current limited jurisdiction that the Postal Rate Commission has over the Postal Service stops at the water's edge. That leaves this government agency free to do internationally what they are prohibited from doing domestically. No other government agency operates without basic oversight over its international activities.

Commission oversight is particularly important because the Postal Service is increasingly using its government status and advantages to undermine free market practices both here and abroad. We contend the Postal Service is using revenue from its monopoly to subsidize products that compete with the private sector, including international services.

This abuse of the monopoly has a direct impact on American consumers, who are now being forced to pay significantly more for first class postage than they otherwise would. Why is the Postal Service asking for another billion dollars every year through the penny increase on the price of a monopoly stamp, when they have generated more than a billion dollars in surplus every year for the past 3 years and are doing so again this year? Is the Postal Service truly planning to improve service and focus on its mandate of universal letter mail service, or is the agency going to use this revenue to subsidize international and domestic services that compete unfairly with the private sector? We suggest it will be the latter.

If the Postal Service were truly committed to its mandate of providing universal letter mail service, why is it entering into numerous other activities wholly unrelated to this mission? The Postal Service is now processing bills, selling mugs, T-shirts and hats, and

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<sup>1</sup> The prepared statement of Mr. Kelly appears in the Appendix on page 65.

hawking telephone cards. What does this have to do with the universal delivery of mail? Absolutely nothing. In fact, it forces the Postal Service to lose focus on its primary mission.

We believe a first step toward rectifying this problem in the international arena is to give the Postal Rate Commission the power to set international rates and services. The result will be more fair and equitable rates because for the first time there would be a real relationship between actual costs and international postal rates. If the playing field is leveled, the Postal Service will be forced to look harder at its primary mandated goal of providing efficient universal delivery of letter mail.

Let me give you some examples of how the Postal Service is currently operating in a manner that is anti-competitive and anti-free enterprise. As a government agency, the Postal Service enjoys numerous advantages that no private company is permitted. I am sure that you and the other Members of the Subcommittee have heard the exhaustive list, but permit me to give you a few highlights.

The Postal Service pays no taxes—Federal, State, or local. It enjoys unfair customs advantages. It is immune from motor vehicle licensing fees for the hundreds of thousands of vehicles it operates on our Nation's highways. It is not subject to OSHA enforcement. And the Postal Service can borrow at favorable interest rates because the Federal Government backs its debts.

But the biggest advantage of all is that the Postal Service is able to use its legally sanctioned monopoly like a weapon against its competitors. The Postal Service amasses about \$60 billion every year in revenue, and about \$50 billion of this comes from its monopoly, which is protected from effective competition. We are all familiar with the phrase that "power corrupts, and absolute power corrupts absolutely." That is certainly true of monopoly power.

Let me give you an example of how the Postal Service is able to use its monopoly unfairly in the international arena. The Postal Service charges \$26.63 to ship a 10-pound package via its Global Package Link from San Francisco to London. That's \$3 less than they charge to ship that same package via Express Mail from Washington, D.C. to Baltimore. Common sense dictates that it can't cost less to send a package overseas than to send it up the road domestically.

During a recent appearance at the National Press Club, former Postmaster General Marvin Runyon tried to explain this anomaly by saying it was an "apples to oranges" comparison because the GPL rate applies only where the shipper sends 10,000 packages overseas. That explanation is disingenuous at best. It implies economies of scale. What the Postmaster General did not say is that in order to get the cheap GPL rate, the shipper need only send 10,000 packages over the course of an entire year to all or any of the 11 countries where GPL service is available. It doesn't take an economist to know that any cost savings in the case of large volume shipments exist only when the large volumes are shipped at one time to one place, and not in bits and pieces over the course of a whole year to different destinations.

So how can the Postal Service afford to charge one-quarter of what the private sector charges for these international shipments?

It can't. The Postal Service is subsidizing the cost of its international competitive services—and of other competitive services—from the revenues it makes on its letter monopoly.

I have no doubt that we would uncover other instances where the Postal Service is unfairly undermining its competition on international rates, if only the data were publicly available. However, the Postal Service has consistently refused to expose to the light of day any meaningful cost and rate information on its individual international services. That is unacceptable in the case of a government agency. In this era when even the CIA is being forced to declassify sensitive information at record speed, you would think the U.S. Postal Service could come clean on its international costs. This refusal to make the information available for public scrutiny leads naturally to the question, "What does the Postal Service have to hide?"

This is an example of why the Postal Rate Commission must be strengthened both domestically and internationally. In fact, the PRC itself has told Congress that it needs more oversight authority precisely because the Postal Service is competing more and more with the private sector.

The bill before you would go a long way toward assuring Congress and the American public that the Postal Service would not be able to abuse its monopoly power. By giving the Commission the same jurisdiction over international postal rates paid by American citizens as the Commission has with respect to domestic postal rates, Congress would dispel some of the questions now being raised, and a fair and rational ratesetting process will foster true and open competition in the global marketplace.

In fact, additional changes are also needed to make Commission review fully effective, both internationally and domestically. The Commission should be given subpoena power, and its decisions should be made final and binding, subject only to judicial review, rather than being reviewed by and subject to modification by the Postal Service through its own Governors.

I would not be before you today if the Postal Service were focusing on its primary mission of delivering first class mail. Unfortunately, the Postal Service is using its government advantages to systematically and unfairly undermine its private sector competitors. We do not object to free and open competition; in fact, we embrace it because it makes us a stronger, smarter company. But we vehemently object to unfair competition on an unlevel playing field where government-granted advantages are used like weapons in the marketplace. Your legislation will take a meaningful step in the right direction by helping to level the playing field internationally.

Thank you for the opportunity to testify on this important subject. I request that my remarks be submitted, and if there are any questions, I would be happy to answer them. Thank you very much.

Senator COCHRAN. Thank you, Mr. Kelly, for your assistance to our Subcommittee. We appreciate your being here and giving us the benefit of your thoughts on this legislation.

What do you think would happen, Mr. Kelly, if Congress did enact this bill, and the Postal Service was subjected in its inter-

national business to regulation by the Board of Governors and the Postal Rate Commission? Would their costs, their prices, go up? Would their charges to their customers, like L.L. Bean, have to go up?

Mr. KELLY. Well, certainly on Global Package Link they would have to go up. No one can believe that the Postal Service is six or seven times more efficient than all the private companies that engage in that same business.

Senator COCHRAN. Mr. McCormick, what is your view of what would happen if this legislation were approved? Would it increase your costs of shipping your goods and your catalogs?

Mr. MCCORMICK. It's not clear to me what the impact on costs would be—

Senator COCHRAN. The prices that you would be charged.

Mr. MCCORMICK. My concern would be the lack of responsiveness from the Postal Service to respond to market needs and to our needs. For example, Mr. Henderson mentioned that it takes 10 months for the PRC to rule on a rate case. What he didn't mention was that it usually takes 4 to 6 months for the Postal Service to gather data for the rate case before it is proposed. So in essence, to come up with a new service or a price or product, it takes a year and a half.

Back in 1994, if we had to go through that process for GPL, we would have missed the entire upside of the Japanese market. During those 2 years, 1994 and 1995, L.L. Bean's Japanese business tripled—in large part, I think, due to GPL and offering a competitive package service. If we had waited a year and a half, we would have missed that upside of the market.

So that's my concern, that the Postal Service would not be responsive to the customer's needs.

Senator COCHRAN. Mr. Smith pointed out the difference in the customs treatment of your business when it is shipped through the Postal Service, as compared with how it's treated when it is shipped by FedEx or UPS.

How big a factor is this as far as your business is concerned?

Mr. MCCORMICK. On the customs clearance, I'm not aware of any advantage that the Postal Service has on the customs. It's my understanding that the General Accounting Office is looking into any advantages the Postal Service may have, and that report is out, I believe, this week.

From my understanding, L.L. Bean packages, once they are landed in Tokyo, they are sorted by Japanese customs officials, and anything under 10,000 yen in value goes through directly to Japan Post—about \$70 in value. Anything above \$70 in value goes into a separate room and is processed separately and is billed to the consumer, to have them pay duties and taxes.

So I'm not sure if that is that dissimilar from all the other shippers.

Senator COCHRAN. What other benefits or special customs arrangements or mailing discounts do you see as benefits for your company when you send overseas mail via the Postal Service?

Mr. MCCORMICK. I may have missed the question.

Senator COCHRAN. What mailing discounts or other customs arrangements do you find that you derive in using the Postal Service

for overseas mail? You were talking about sending your catalogs out, that this is a very important part of your business.

Mr. McCORMICK. Right now we send our catalogs to Japan through the USPS. We do not use the Postal Service for mail to other countries. Right now we have an agreement with the Postal Service to send our parcels and catalogs to Japan, and that's the only arrangement we have right now.

Senator COCHRAN. Mr. Smith, you pointed out in your statement the other obligations that you have that the Postal Service doesn't have, to pay taxes and to comply with OSHA regs and to meet the demands of the customs service and all the rest. Are you suggesting that we probably ought to include in this legislation some requirement that the Postal Service is subjected to the same kinds of rules and laws that both your business and Mr. Kelly's are subject to?

Mr. SMITH. Mr. Chairman, during my remarks I noted a bill that was in the House, sponsored by Congressman McHugh. We support the philosophy behind that bill, which is to not preclude the Postal Service from doing whatever it wants to do, but dividing their services into two parts, the competitive and the monopoly, and have a very strong oversight by the PRC and assure that appropriate levels of overhead and compensatory payments are made by the Postal Service for the business privileges, just as the private sector does.

I might add, Mr. Chairman, that the GAO report is going to be very clear about this issue on the USPS thing. I am amazed to hear the gentleman from L.L. Bean state that he's not aware of the differential treatment of postal services around the world. We have a very big business in Japan; I've been in the customs locations there many, many times, and I can assure you that the postal clearance system is a radically different system than the private clearance system. For all intents and purposes, there is no clearance system, because as I pointed out, this is an exact document. That is the documentation that's required on a postal movement to Japan or anyplace else. But the most significant difference is that the carrier in the private sector is legally responsible to the customs authorities in the importing country for that declaration as to value, as to any kind of contraband, or whatever the case may be, and the Postal Service has no such obligation.

Now, when you have a fine company like L.L. Bean, the height of integrity, that's not a problem. It's a huge problem when you're talking about a lot of people that want to ship a lot of different things around the world in terms of security and contraband and so forth. It's a radically different system, and it confers on the Postal Service for low-value items and anything moved through the Postal Service significant advantages, as the GAO report will make clear, I'm sure.

Senator COCHRAN. Senator Levin.

Senator LEVIN. Thank you, Mr. Chairman.

You indicated, both of you, that there's a cross-subsidy that exists. How do you prove it?

Mr. SMITH. Well, Senator, I think that if the PRC had the type of real enforcement powers that it ought to have in being able to audit the Postal Service's books, it would be pretty clear what's going on.

Senator LEVIN. But I mean, what's your proof of the statement that there is currently a cross-subsidy? Your bids at L.L. Bean were fairly close, you indicated?

Mr. MCCORMICK. There was one other company very close to USPS.

Senator LEVIN. I'm not sure about the "six times" reference. I want to get back to that in a minute.

But if they got two bids that were close to each other at L.L. Bean, what is the proof of the fact, without looking into their numbers—which you haven't been able to do, nor has anybody else—that there is a cross-subsidy?

Mr. SMITH. Well, Senator, I've been in this business now for well over 25 years. I founded FedEx, and I've got a pretty good handle on what it costs to pick up, transport, and deliver things across the United States or around the world. We have about a \$4 billion international business, and I can assure you that the private sector could not begin to be charging the rates that the Postal Service is charging for this business, and be producing—as the Postmaster General said—\$33 million in business.

The cross-subsidization—you may have been out of the room when I mentioned this—part of the problem is, when you get debating this issue, you always get down on specifics, and you talk about, well, Global Package Link, and is it being cross-subsidized or is it not? It's better to refer to this, in my opinion, as a major diversification effort by a public monopoly, because what the Postal Service is doing is to take the stream of revenues which they have produced over the years to other countries around the world, for moving first class mail, and then what they do is layer on top of that—they just put in these shipments that they're going to carry in the commercial sector. So they don't attribute any equivalent line haul costs to those shipments the way that UPS or FedEx does, who fly their own airplanes across the ocean and so forth.

Now, if it's the intent of the Congress, if you want a monopoly business to get involved in a lot of businesses that are commercially done, that's fine; that's your choice to make. But you ought to deal with it on that much broader issue and not get hung up on the specifics of these individual things, because it's very hard to pull the monopoly part of the Postal Service and their competitive services apart. I could sit here—and I'm sure Mr. Kelly could—and talk for 2 days about that.

Senator LEVIN. You don't think there's going to be any purpose served by that audit of Ernst and Young? You don't think that audit is going to show us anything?

Mr. SMITH. Well, it will be an estimate. I'm sure it's a good faith estimate, and from their point of view, I'm sure the Postal Service thinks that this is totally logical. I mean, they ought to be able to do all these things. And their attribution of costs—say, at Global Package Link—will be to say, well, we've got this \$1.7 billion worth of revenue on there, so it doesn't cost us very much to put \$33 million of Global Package Link stuff. But it misses the much bigger issue, which is, is it in the public interest for the government to create subsidized—and they are subsidized, for all the reasons we've gone over—activities which are also produced in the private

sector? That's why I use the example about the Bugs Bunny tie. I mean, why not let—

Senator LEVIN. I presume that's part of their advertising budget. They would consider that advertising, I assume; I don't know—

Mr. SMITH. A Bugs Bunny tie?

Senator LEVIN. I assume so.

Mr. SMITH. No, sir. I think their view is—

Senator LEVIN. I doubt very much that they're in the tie business to make profit off those ties. My hunch is that those ties are promoting stamps, and they're in the stamp business.

Mr. SMITH. Well, having gone to the Postal Service and talked to the Senior Vice President of Marketing, and former Postmaster General Runyon is a very good friend of mine, I admire him greatly, and so forth, but I think the Postal Service is in the process of a major diversification effort, and if selling ties brings more people into the location where they can then sell more Global Parcel Link, which is cross-subsidized by monopoly rent—that's why it's so hard to take these sinews and pull them apart. You have to look at the much broader issue, and that's why we support the approach over on the House side in the McHugh bill, because it's a broad-gauge approach to what we think is a very broad-gauge problem.

Senator LEVIN. All right. I think it's useful to us, however, to disaggregate to the extent we can to see whether or not in fact there is a cross-subsidization.

Mr. SMITH. Well, I just gave you the best example I could, \$1.6 billion, cross-subsidization—

Senator LEVIN. I understand. My question, though, is this. Would you be willing, both of you, to look at the Ernst and Young audit and critique it?

Mr. KELLY. I would think a more logical way to do it would be to have the Postal Rate Commission have the oversight that Congress intended—

Senator LEVIN. That's a chicken/egg issue.

Mr. KELLY. That's exactly right.

Senator LEVIN. But in order to get to either the chicken or the egg—

Mr. KELLY. It has to be an unbiased outside third party that audits in order to get the answers to the kinds of questions that you're asking. And the reason you can't get the answers is because of a lack of information, their refusal to provide that information, particularly to the Postal Rate Commission.

Senator LEVIN. You've got a chicken/egg problem here. In order to get either the chicken or the egg, we are going to look at an Ernst and Young audit—we've asked them for it—some of us will look at it.

Would you be willing to give us your perspective—you have not seen that audit, have you?

Mr. SMITH. No, sir.

Senator LEVIN. Would you be willing to show us, from your perspective, what's missing?

Mr. KELLY. Certainly. I'd be willing to do that, yes.

Mr. SMITH. We would, too.

Senator LEVIN. All right.

On the customs requirements, Mr. Smith, that are not applied to you—

Mr. SMITH. That are applied.

Senator LEVIN [continuing]. That are applied to you that are not applied to the Postal Service, is that long printout of yours, is that something that is required by a foreign country?

Mr. SMITH. In our country.

Senator LEVIN. So part of that is required by our government, that printout?

Mr. SMITH. Here's what we have to do, Senator. Let's say FedEx, on one of our MD-11s, is going across the Atlantic or the Pacific, going to Tokyo or Paris or London. When that airplane lands in London, every piece on that airplane—every piece—has to correspond exactly to a manifest that we have submitted to the customs authorities that tells who shipped that item, when it was shipped, what the commercial value of that item is, a complete description of that item, and an estimate of the duties that are due. And if anything on that manifest is erroneous, we are responsible and subject to fines or customs claims and so forth.

The Postal Service, when their customers fill out this little green thing, there is no manifest. It just goes anonymously into the airplane, in the underbelly, generally, of a passenger airplane, sometimes on cargo airplanes. And in the case of Global Package Link, they send an electronic advice forward. But the vast majority of postal items that are sent through the system aren't subject to any of those types of customs controls.

I mentioned during my testimony that I am reliably informed that the customs service is going to provide a report themselves which details the very significant differences that are applied to postal shipments than to those carried by commercial carriers. This is an area of great concern. There is a GAO study, and there is also a report that the customs authorities themselves are doing.

Senator LEVIN. My question, though, is that manifest a foreign customs requirement or is it our government's requirement?

Mr. SMITH. Well, it depends. If it's going to a foreign customs country, it is required on the import side by the foreign customs folks, and it is required by the U.S. Customs folks on the export side.

Senator LEVIN. Both? When you are shipping packages and you have to fill out a manifest to land at Heathrow Airport—

Mr. SMITH. It's much more than a manifest. It's a shipping document, of which this is just a summary.

Senator LEVIN. OK.

Mr. SMITH. It's a shipping document that you have to fill out.

Senator LEVIN. When you land your plane at Heathrow, is that document required by the British authorities or by us?

Mr. SMITH. By the British authorities.

Senator LEVIN. OK. And you're suggesting that the Postal Service tell the British authorities that they should be bound by the same thing?

Mr. SMITH. You can do it either way. You can make the same regulations that apply to the Postal Service apply to us, or you can make the regulations apply to us that apply to the Postal Service.

Senator LEVIN. That's an argument with the British authorities, is it not?

Mr. SMITH. Sir?

Senator LEVIN. That's an argument that we should take up with the British?

Mr. SMITH. Yes, and that's exactly why we are so urgent in our request that there be someone other than the Postal Service sitting at the Universal Postal Union, because what will happen is, the UPU gets together and they say, "We have these government-to-government agreements, and the Postal Service are exempt from all of these customs requirements," and Her Majesty's Customs don't have any say-so about it, and U.S. Customs doesn't. That's precisely why the U.S. Customs are going to come out with this report.

Senator LEVIN. OK. Mr. Kelly, let me ask you a question.

What do you estimate the total percentage of international shipments to be that are private, and what percentage is the Postal Service? Lumped together, all the private entities. Do you and your colleagues in the private world have 90 percent of the international business, and the Postal Service 10 percent?

Mr. KELLY. I'm not sure what percent the Postal Service has, but I believe they have 43 percent of the worldwide mail market. The question was asked earlier in the day. I don't know what percent of the package or express letter market they would have.

Senator LEVIN. Could you give us a rough estimate?

Mr. KELLY. I really don't know. I know DHL and Federal Express and ourselves and TNT—and there are tens or twenties of players in that particular market—I don't know what that particular number is.

Senator LEVIN. Do you have an estimate, Mr. Smith?

Mr. SMITH. I would say that the Postal Service's presence in the express mail market is pretty small.

Senator LEVIN. The GAO report here says it's 4 percent.

Mr. SMITH. That doesn't surprise me.

Senator LEVIN. Would that surprise you, Mr. Kelly?

Mr. KELLY. No, it does not.

Senator LEVIN. My last question. One of you said that there are different rules relative to advertising.

Mr. SMITH. I did.

Senator LEVIN. Could you expand on that a little bit?

Mr. SMITH. Well, the Postal Service has been in the express mail business for many years, as I'm sure you're aware. And from about the middle part of the 1970's until the current time, the Postal Service has seen its market share decline—these won't be totally accurate, but it's not far off—from about 40 or 45 percent of the express mail business to about 7 percent, and it's sort of leveled off there.

Now, express, by our definition, is something that needs to be moved fast. It needs to be moved on a time-certain basis, meaning you get a guaranteed delivery, and the people who give it to you want you to keep control of it. That's why we developed our famous tracking and tracing system that lets people move express documents and express packages and express freight. We do all three.

The Postal Service began to promote a service some years ago which they called Priority Mail. Now, Priority Mail is not regular mail, it's not express, it sort of fits in between, and they began to market it originally—they had a famous advertising campaign that went "2-2-2." You might remember that; it was real "in your face" type advertising, \$2 and 2 days and 2—whatever the case might be. They were hauled up here before Congress, and Senator Pryor made them change it, because it wasn't \$2. It was \$2.90, and it didn't get there in 2 days; it got there between 2 and 5 days, and so forth.

So they decided that they had a real market opportunity here to compete in this sort of near-express business, and they began promoting Priority Mail. But when they advertise Priority Mail, they don't advertise it as "this service doesn't have a guarantee," "this service isn't tracked," "this service gets there in 2, and sometimes 3 and 4 days," "there's no ability to guarantee this on Saturday." They began to compare it directly to UPS and FedEx as if it was a direct competitor to our overnight services—or, in the case of the much smaller 2-day service that we provide, we're not even able to compete with them on a price basis because it's prohibited by the Postal Service's own statutes, if it's a letter-type shipment.

So the advertising is just misleading, and it's false. For instance, they say, "We don't charge anything extra to deliver on Saturday." But you can't get a guaranteed delivery on Saturday. So we sued them in court—not because of our desire to keep them out of the Priority Mail business, but because the advertising, by the standards we're held to, would be deemed to be false and misleading. The Postal Service's defense in that lawsuit was that they were exempt from these rules because they were under the Lanham Act, which exempts government agencies from private suit.

Now, I'm not a lawyer or General Counsel, but I believe that they have lost that argument in the first round, and they're now appealing that, because the judge said, "Look, maybe in your monopoly business over here, that's true; but you're getting over here in the commercial sector and competing with folks." So that's what I was talking about.

Senator LEVIN. The current state of the law in that one case is that they're governed by the same advertising rules when they're dealing in commercial businesses? That's the most recent opinion?

Mr. SMITH. No, sir. The most recent opinion would be on the Postal Service's side, that they're a government agency and can't be sued—

Senator LEVIN. They won the case?

Mr. SMITH. No. We, for the first time, have—I think this would be the best way to put it. Their conduct was so egregious that it went up before a Federal judge, and for the first time a Federal judge said, "You know, you're right. This thing sort of goes over the edge."

Senator LEVIN. At least in that case, you got a court order.

Mr. SMITH. Well, there was another case, too, Senator. I'm not familiar with the exact citation, but there was another private case brought on exactly the same over-the-top rationale, and there was that decision, and then I believe our decision was favorable to us,

and that's gone to appeal. We'll submit to you, if you want, the exact—

Senator LEVIN. We can check it out. Thanks.

Mr. KELLY. It goes, though, "I want to be a private business 1 day, and I want to be a government monopoly the next day on a different issue."

Senator LEVIN. Thanks.

Senator COCHRAN. Senator Cleland.

Senator CLELAND. Thank you very much for all of you being here, Mr. Smith, Mr. Kelly, and Mr. McCormick.

Mr. Smith and Mr. Kelly, I appreciate you all particularly advocating that we must absolutely, positively run a tighter ship in the government's shipping business. [Laughter.]

Let me just say that I am fascinated by the amount of issues that we've uncovered here, particularly Mr. Smith. You've taken this to a deep level that I really didn't expect, but this is your business and you've been in it a long time and you're a pioneer in it. I appreciate your insights into the Postal Rate Commission, the advocated customs reform, and the need for the government itself to have a representative in dealing with international matters in terms of shipping, other than the Postal Service. Those are fascinating issues that we want to explore.

What I'd like to do is take it maybe even a little more broadly, which I think is fascinating. Mr. Kelly, 5 years down the road, in terms of international trade and international shipping, based on the businesses that you all are into, where is this country going? Is this the kind of reform that we absolutely, positively need to get ourselves squared away, to not unnecessarily compete in the private sector, and to allow the Postal Service to do its thing? Is this the kind of reform that you all see as critical to our ability as a country to relate and magnify our options in international trade? Give us your view 5 years down the road. Is this one of the things we have to do?

Mr. KELLY. Well, Senator, we view ourselves as a facilitator of global trade. And if in fact the kind of predatory pricing that we're experiencing right now as a result of Global Package Link continues to exist, continues to become expanded, there's no way any private carrier could compete with it. Obviously, our ability to trade would be relying on one particular carrier, and that would be the Postal Service, if that kind of pricing continues.

Senator CLELAND. Thank you. Mr. Smith.

Mr. SMITH. Well, Senator, that's a very good question, because it has very, very broad strategic implications. Unfortunately, because of a lot of the other issues going on in Washington, the President's speech last week before the WTO didn't get much play, but in it he talked about the significance of international trade to this country's well-being and economic health, and how important it was to liberalize trade in general, and called for a number of initiatives. He specifically noted that trade in services was becoming as important as trade in manufactures, and he noted that there had been significant progress in telecommunications; there had been significant progress in financial services, and very little improvement in transportation. And the President himself specifically mentioned express delivery services.

Well, why did he do that? He did it because today the sinews that connect the United States with its trading partners are increasingly becoming air links and not seafair. Of the total amount of trade conducted by the United States today, about 20 percent of it goes to Canada and Mexico, so it doesn't go across oceans. But of the 80 percent that does go across oceans, 42 percent is carried by ship and 38 percent of that value is now carried by air, even though the amount that is carried by air is less than 2 percent of the tonnage.

So when you see CNN, when they're talking about international trade and you see those big container ships and what have you, that's the trade of the 1970's, not the trade of 2010—computers, electronics, pharmaceuticals, medicines, aircraft parts, auto parts, they're going through airborne trade links, and increasingly, door-to-door express delivery systems like FedEx and our friends at UPS and our other able competitors.

So these are the ways the United States will trade with other countries, and it is a very large national issue because, as I said before, what the Postal Service really wants to do is to diversify. And they see this growth in international trade, the current Asian crisis notwithstanding, and they want a piece of that action. And we don't care if they're in there. As we said over and over again, we're perfectly willing for them to go compete, but we want them to have a set of rules on the commercial sector that are similar to ours, and they should not be able to cross-subsidize and, as Mr. Kelly said, charge significantly below cost, meaning the cost of any commercial entity providing these services, because all that is, really, is a cross-subsidization of their government monopoly in its broadest sense against private competition, which pays taxes, which buys license plates, and which is subject to OSHA and all the other things we have to do.

Senator CLELAND. And this legislation before us, you feel, is a step forward in that direction in the sense that it gives the Postal Rate Commission a little broader oversight, doing what it does domestically—doing that vis-a-vis the Postal Service internationally; not an attempt to particularly wipe them out, but to get to the bottom of the data and let everyone know, and also properly regulate that as they see the Postal Service mission? I think that's part of what we're at here. What is the mission of the Postal Service? You get right down to it, you're a military person, a fellow Vietnam guy, I think that's part of what we're arguing about here, Mr. Chairman, is determining what the proper role of the Postal Service is and its particular role in international communications, travel, and trade.

Well, in terms of this legislation, you mentioned oversight. Mr. Smith and Mr. Kelly, your view of the Postal Rate Commission and its role in terms of international affairs of the Postal Service is not just setting rates or looking at rate data, but it has to do with the proper role of the Postal Service in that regard. Is that correct?

Mr. KELLY. The same kind of oversight the Postal Rate Commission has here in the United States domestically is the kind that it should have regarding the Postal Service in international business.

The argument you heard about the ability to compete in international markets is the same argument that exists in the United

States. Your ability to compete in markets is dependent upon the services you can offer your customers, and speed, and those kinds of issues. Well, the same arguments are here internationally. If you accept those, if you accept that the Postal Service should have a free hand to do whatever it pleases and use its monopoly power however it chooses to, those same arguments exist here in the United States with the Postal Rate Commission's ability to see what happens to you. The exact same argument.

Senator CLELAND. Do you happen to see, Mr. Kelly, that the bureaucracy of the 10-month analysis of the process to get to a decision—is that particularly burdensome on the Postal Service? Or is that just part of their doing business?

Mr. KELLY. I think the process should be hastened. As I understand it, a great deal of the delay in the process is caused by the Postal Rate Commission's inability to get information from the Postal Service. So that process indeed should be hastened, and we would encourage that to happen on a much more expeditious level.

Senator CLELAND. Well, thank you all very much for coming. Thank you, Mr. McCormick.

Thank you, Mr. Chairman.

Senator COCHRAN. Thank you, Senator.

There was some discussion about the representation by the Postal Service on the UPU. What is the view of this panel about whether or not that should be changed to permit private operators to also be represented in the UPU? Should there be a corresponding requirement that universal service obligations be assumed, and standards that are set by the organization be assumed as well?

Mr. Kelly, what is your view?

Mr. KELLY. My reaction is that there should be a government agency involved in that process, whether it is the State Department or the Department of Transportation or whomever. It would be like having United Airlines participate in bilateral negotiations without any input from the Department of Transportation or the State Department. Certainly, if they're going to negotiate and make the rules for what happens regarding international trade and customs and other issues that affect the private sector, the private sector—or some other branch of the government—ought to be involved in that process.

Senator COCHRAN. Do you think any additional requirements ought to be placed on private companies, such as having to provide mail services or parcel services, within the United States at affordable prices, for any kind of international obligation to come under scrutiny or Federal regulations to ensure that prices charged are justified by the cost?

Mr. KELLY. The private sector is under a great deal of scrutiny from dozens of government agencies, including the IRS and including a host of other agencies that we come under great scrutiny from, all of which the Postal Service is excluded from. To the extent to which that should be increased, I would not vote favorably.

Senator COCHRAN. What would be the response if you were asked if your company could compete in the international marketplace if your prices were subject to Postal Rate Commission control? What would your reaction be to that, Mr. Smith?

Mr. SMITH. Well, my reaction to that would be as follows, Senator. Again, I keep going back to this much larger question, because you can't separate the tactical from the strategic.

The Postal Service's Government monopoly extends to letter mail, nothing else. It has no monopoly nor a mandate to provide parcel service or many other services that they provide. If the Congress wants to reregulate the movement of goods after 20 years of dismantling that, with first the Air Cargo Deregulation Act of 1977, the Interstate Deregulation Act of 1980, and then the Intra-state Preemption Act in 1994, that would be your prerogative. And then if we're all under the Postal Rate Commission or ICC or DOT, that's your choice.

We believe that the competitive marketplace has provided enormous benefits to the shipping public in North America and internationally. I don't think that that issue is the appropriate one here, because it's the issue of the cross-subsidization, not the issue of regulation.

Senator COCHRAN. Other Senators have asked us to submit questions. We have some questions from Senator Torricelli for the Postmaster General, which we will submit on his behalf, and ask that they be answered for the record.

[The questions submitted by Senator Torricelli and the answers thereto follows:]

#### QUESTIONS SUBMITTED BY SENATOR TORRICELLI

I know that, as Postmaster General, you have the responsibility for appointing members to the Citizens Stamp Advisory Committee (CSAC). These 13 individuals have the immense responsibility of reading and evaluating over 40,000 recommendations for postage stamps every year.

Do you plan on solely accepting their recommendations for new stamp issues, or, as Postmaster General, do you plan on making your own recommendations? Specifically, the CSAC rejected a petition to issue a stamp in honor of the 100th Anniversary of the Jewish War Veterans of America, our Nation's oldest veterans' organization. Would you be willing to overrule the recommendation of the CSAC to issue a commemorative stamp that they have rejected?

*Answer:* As you indicate, the dedicated and talented individuals who serve on the Citizens' Stamp Advisory Committee have the formidable—and challenging—task of reviewing the many thousands of stamp proposals we receive each year and recommending the adoption of the relatively small number that can be selected. Their strengths, both individually and collectively, have assured that the Postal Service's stamp program is one of the finest and most diverse of any of the world's 189 postal administrations. The wide variety of interests, backgrounds, and accomplishments of the committee's members assure that their recommendations are representative of all sectors of our society.

That is an equation that I respect—and one that the Postal Service has respected—for over 40 years. I do not anticipate substituting my judgment for that of the committee in reviewing and recommending the subjects for our commemorative stamp program.

While the Committee has reviewed the proposal for a commemorative stamp recognizing the 100th anniversary of the Jewish War Veterans on a number of occasions, it was not recommended for issuance. However, I am pleased to report the committee is considering a proposal for a commemorative stamp honoring all of those who served—American veterans.

Senator COCHRAN. I am also going to ask that we place in the record this advertisement from Royal Mail that was identified by

one of our earlier witnesses, so that we will have that in the record, as well.<sup>1</sup>

Let me say again how much I appreciate the assistance that you have all provided to our Subcommittee in gaining an understanding of this issue and of the specific legislation that we have pending before our Subcommittee. We thank you very much for doing that, and for taking time from your busy schedules to be with us today for this purpose.

Without any further indication of items to be included in the record, I will announce that the hearing on this legislation has been completed, and we will stand in recess until the call of the Chair.

[Whereupon, at 4:17 p.m., the Subcommittee was adjourned, to reconvene at the call of the Chair.]

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<sup>1</sup>The Ad from Royal Mail appears in the Appendix on page 45.



## A P P E N D I X

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II

105<sup>TH</sup> CONGRESS  
2<sup>D</sup> SESSION

# S. 2082

To amend chapter 36 of title 39, United States Code, to provide authority to fix rates and fees for domestic and international postal services, and for other purposes.

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IN THE SENATE OF THE UNITED STATES

MAY 14, 1998

Mr. COCHRAN introduced the following bill; which was read twice and referred to the Committee on Governmental Affairs

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## A B I L L

To amend chapter 36 of title 39, United States Code, to provide authority to fix rates and fees for domestic and international postal services, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*  
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. AUTHORITY TO FIX RATE AND CLASSES.**

4 (a) **SHORT TITLE.**—This Act may be cited as the  
5 “International Postal Services Act of 1998”.

6 (b) **AUTHORITY.**—The first sentence of section 3621  
7 of title 39, United States Code, is amended to read as  
8 follows: “Except as otherwise provided, the Governors are  
9 authorized to establish reasonable and equitable classes of

1 mail and reasonable and equitable rates of postage and  
2 fees for domestic and international postal services in ac-  
3 cordance with the provisions of this chapter.”.

○

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Office, at 152 Madison Avenue, Suite 200, New York, NY 10016.



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Washington, D.C. 20036

■ Phone: 202 327 6000

June 1, 1998

Mr. Michael J. Riley  
Chief Financial Officer  
Senior Vice President  
United States Postal Service  
475 L'Enfant Plaza S.W.  
Washington, D.C. 20260

Dear Mr. Riley:

The attached Cost and Revenue Analysis for the Postal Service for the year ended September 30, 1997 contains information regarding revenue and costs by category of mail. As further described in the notes to the report, the report is the product of the application of the Postal Service's revenue, volume, weight and cost estimation and allocation processes and provides information useful as a starting point in assessing cross subsidy issues. Briefly, categories of mail with a negative margin are categorized by the Postal Service as being cross subsidized before application of the recent rate decision because they are not covering their marginal or incremental costs as applicable. Our report thereon expresses an unqualified opinion that the Postal Service applied its methodologies in developing the FY 1997 report.

Within the context of the overall report and recognizing the variability of estimates derived from the statistical systems for small categories, the international mail category (representing less than 2% of Postal operations) in aggregate reflected positive contribution in 1997, an indication based on the Postal Service allocation and estimation processes that no aggregate cross subsidy at the marginal or incremental cost level existed in 1997.

Yours very truly,

A handwritten signature in dark ink, appearing to read 'Daniel J. Murrin'.

Daniel J. Murrin  
Partner

Attachment



■ 1225 Connecticut Avenue, N.W. ■ Phone: 202 327 6000  
Washington, D.C. 20036

### Report of Independent Accountants

Board of Governors  
United States Postal Service

We have examined the following tables of financial information ("the Summary Tables") included in the Cost and Revenue Analysis of the United States Postal Service (Postal Service) for the year ended September 30, 1997:

- Summary of Revenue and Cost for Major Service Categories and
- Summary of Revenue and Cost for Major Service Categories - Volume Statistics.

The Summary Tables are based on information in the postal system of accounts used in preparing the financial statements, as well as various postal operational and statistical information sources. Our examination of the Summary Tables was made in accordance with standards established by the American Institute of Certified Public Accountants and was, therefore, designed primarily for the purpose of expressing an opinion on the Summary Tables taken as a whole. Accordingly, our examination included such procedures as we considered necessary under the circumstances. We believe our examination provides a reasonable basis for our opinion.

In our opinion, the Summary Tables mentioned above present fairly, in all material respects, the allocations of the United States Postal Service revenue and costs among the indicated categories of mail and services provided by the Postal Service during the year ended September 30, 1997, on the basis described in the Notes to the Summary Tables.

As discussed in Notes 1, 2, and 12 to the Summary Tables, in 1997 the United States Postal Service revised its methodology to determine the distribution of Postal Service costs by categories of mail or service. One component of the revised methodology includes the use of Management Operating Data System (MODS) work hours and Total Piece Handlings data to develop and distribute the Postal Service's mail processing costs by categories of mail.

*Ernst & Young LLP*

May 20, 1998



**COST AND REVENUE ANALYSIS**

**FISCAL YEAR 1997**

**FINANCE**

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SUMMARY OF REVENUE AND COST FOR MAJOR SERVICE CATEGORIES  
Fiscal Year 1997

Classes and Sub-Classes of Mail (note 1)	(In millions)		(per piece)		Marginal Cost E (note 4)	Revenue D	Volume Variable Cost C (note 3)	Contribution Margin % (note 5) (D-E)/D	Cost Coverage (note 6) (D/E)
	Revenue A (note 9)	Incremental Cost B (notes 2&12)	Incremental Cost E (note 4)	Revenue D					
<b>First-Class Mail:</b>									
Letters and sealed parcels.....	\$32,238.2	\$16,994.0	\$15,743.4	\$0,342	\$0,167	\$0,178	51.17%	204.77%	
Cards (note 13).....	994.4	625.5	609.2	0.180	0.114	0.072	39.73%	163.22%	
Fees.....	164.9	-	-	-	-	-	-	-	
Total First-Class.....	33,397.5	17,709.8	16,352.7	0.335	0.164	0.171	51.04%	204.23%	
Priority Mail.....	3,859.9	2,201.0	1,851.1	3.611	1.761	1.850	51.23%	205.03%	
Express Mail.....	824.7	611.9	362.4	12,969	5,698	7,265	56.05%	227.54%	
Mailgram.....	2.0	1.4	1.4	0.372	0.259	0.112	30.27%	143.41%	
<b>Periodicals:</b>									
In-country.....	80.9	82.4	80.9	0.085	0.085	0.000	0.00%	100.00%	
Outside the country:									
Regular publications.....	1,838.3	1,847.7	1,828.6	0.226	0.210	0.016	6.88%	107.39%	
Nonprofit publications.....	316.1	342.9	337.0	0.147	0.157	(0.010)	-6.81%	93.80%	
Classroom publications.....	19.2	10.8	10.8	0.162	0.172	(0.010)	-6.03%	94.32%	
Fees.....	22.0	-	-	-	-	-	-	-	
Total Periodicals.....	2,067.5	1,895.4	1,854.3	0.199	0.168	0.031	5.48%	105.79%	
<b>Standard Mail (A)</b>									
Single piece rate.....	137.3	228.8	228.3	0.892	1.322	(0.520)	-58.53%	60.87%	
Enhanced carrier route.....	4,582.3	1,679.0	1,863.0	0.144	0.260	0.085	58.64%	241.75%	
Regular.....	9,776.8	4,280.7	4,465.7	0.205	0.135	0.073	34.98%	153.82%	
Nonprofit enhanced carrier route.....	219.9	186.2	186.2	0.077	0.054	0.022	28.99%	149.92%	
Fees.....	1,122.3	1,084.0	1,084.0	0.109	0.105	0.004	3.83%	103.96%	
Total Standard Mail (A).....	12,978.6	8,199.1	7,741.1	0.167	0.100	0.066	39.86%	160.35%	
<b>Standard Mail (B):</b>									
Parents zone rate (note 10).....	771.2	649.0	635.4	3.255	3.526	(0.271)	-8.35%	92.31%	
Bound printed matter.....	451.9	333.1	330.5	0.866	0.833	0.233	26.86%	136.73%	
Special standard.....	398.7	223.9	222.7	1.700	1.098	0.601	37.57%	160.19%	
Library mail.....	48.3	48.3	48.2	1.875	1.783	(0.091)	-4.86%	93.91%	
Fees.....	2.0	-	-	-	-	-	-	-	
Total Standard Mail (B).....	1,627.0	1,477.7	1,436.8	1.846	1.454	0.192	11.89%	113.24%	

See accompanying notes.

SUMMARY OF REVENUE AND COST FOR MAJOR SERVICE CATEGORIES  
Fiscal Year 1997

	(In millions)			[per piece]			
	Revenue (note 6) A	Incremental Cost (notes 2&12) B	Volume Variable Cost (note 3) C	Revenue D	Contribution Margin		Cost Coverage (note 8) (D/E)
					Marginal Cost (note 4) E	\$ (D-E)	
Classes and Sub-Classes of Mail (note 1)							
Free mail - blind, hand-capped & servicemen.....	-	\$25.4	\$25.4	-	N/A	N/A	0.00%
International mail (note 9).....	\$1,614.0	1,341.6	1,265.1	\$1,604	\$0,347	21.66%	127.64%
Total mail.....	\$6,268.4		31,020.2	0,296	0,132	44.87%	161.30%
Special Services:							
Registry (note 14).....	94.9	113.5	77.5	5,836	4,765	1,071	18.35%
Auxiliary services.....	4.2						
Total Registry.....	99.1						
Certified (note 14).....	333.1	294.9	329.4	1,157	1,144	0,013	1.13%
Auxiliary services.....	263.0						
Total Certified.....	622.7						
Insurance (note 14).....	61.0	48.5	48.9	1,006	1,389	0,417	23.09%
Auxiliary services.....	1.7						
Total Insurance.....	62.7						
COB (note 14).....	21.8	14.7	16.0	4,927	3,194	1,443	31.19%
Auxiliary services.....	0.0						
Total COB.....	21.8						
Special delivery.....	1.4	3.3	3.3	9,978	23,448	(13,468)	-134.87%
Money orders (note 7).....	267.1	162.7	134.7	1,296	0,554	0,842	49.56%
Stamped envelopes.....	17.1	11.8	11.8				
Special handling.....	0.7	1.3	1.3				
Post office box.....	677.6	471.7	471.7				
Other.....	-		120.0				
Total Special Services.....	1,674.1	1,211.4	1,211.4				
Miscellaneous items (note 9).....	247.2						
Total mail and services (note 8).....	\$8,167.7		32,231.6				
Appropriations: Revenue forgone.....	83.4						
Total operating revenue.....	\$8,271.1						
Investment income.....	59.7						
Total (note 7).....	\$8,330.8		32,231.6				
All other costs.....	-		24,834.7				
Total costs (note 7).....	-		57,068.4				

See accompanying notes.

SUMMARY OF REVENUE AND COST FOR MAJOR SERVICE CATEGORIES  
Fiscal Year 1987  
VOLUME STATISTICS

Classes and Sub-Classes of Mail (note 1)	Pieces (thousands)	Weight in Pounds (thousands)	Weight per Piece (ounces)	Cubic Feet (thousands)	Weight per Cubic Foot (pounds)
<b>First-Class Mail:</b>					
Single-Piece letters.....	54,240,238	2,504,814	0.7	179,808	13.9
Presort letters.....	40,082,616	1,572,482	0.6	112,754	13.9
Total Letters.....	94,302,854	4,077,276	0.7	292,382	13.9
Single-Piece cards.....	3,083,755	16,784	6.1	1,351	13.9
Presort cards.....	2,353,333	19,023	0.1	1,388	13.9
Total cards.....	5,357,088	37,807	0.1	2,719	13.9
Total First Class.....	99,659,942	4,115,083	0.7	295,081	13.9
Priority Mail.....	1,068,161	1,860,908	27.9	147,177	12.6
Express Mail.....	63,633	76,348	19.2	10,784	7.1
Mailgram.....	5,326	0	0.0	0	0.0
<b>Periodicals:</b>					
In-county.....	947,047	252,500	4.3	13,721	16.4
Outside the county:					
Regular publications.....	7,254,321	3,472,633	7.7	194,695	17.8
Nonprofit publications.....	2,147,170	990,932	4.3	35,484	16.4
Classroom publications.....	62,666	32,360	8.2	1,889	17.1
Total Periodicals.....	10,411,404	4,338,325	6.7	245,989	17.6
<b>Standard Mail (A)</b>					
Single piece rate.....	171,188	30,727	2.9	2,546	12.1
Commercial-Standard (A)					
Enhanced carrier route.....	31,504,820	4,516,459	2.3	255,557	17.7
Regular.....	32,627,736	4,260,469	2.1	242,204	17.7
Total Commercial.....	64,032,556	8,796,928	2.2	497,761	17.7
Nonprofit-Standard (A)					
Nonprofit enhanced carrier route.....	2,871,973	193,734	1.1	11,835	16.4
Nonprofit non carrier route.....	10,177,913	672,489	1.1	41,083	16.4
Total Nonprofit.....	13,049,886	866,223	1.1	52,918	16.4
Total Standard Mail (A).....	77,253,630	9,693,878	2.0	553,227	17.5

See accompanying notes.

**SUMMARY OF REVENUE AND COST FOR MAJOR SERVICE CATEGORIES**  
**Fiscal Year 1997**  
**VOLUME STATISTICS**

Classes and Sub-Classes of Mail (note 1)	Pieces (thousands)	Weight in Pounds (thousands)	Weight per Piece (ounces)	Cubic Feet (thousands)	Weight per Cubic Foot (pounds)
<b>Standard Mail (®):</b>					
Parcel zone rate.....	239,928	1,264,004	85.4	180,180	7.0
Bound printed matter.....	521,726	1,237,431	37.9	83,077	14.9
Special standard.....	202,732	334,871	26.4	31,840	10.6
Library mail.....	27,018	53,503	31.7	3,970	13.5
<b>Total Standard Mail (®).....</b>	<b>989,404</b>	<b>2,889,809</b>	<b>46.6</b>	<b>296,047</b>	<b>9.7</b>
<b>US Postal Service.....</b>	<b>377,330</b>	<b>88,385</b>	<b>3.7</b>	<b>6,275</b>	<b>14.1</b>
<b>Free mail - blind, handicapped &amp; servicemen.....</b>	<b>53,301</b>	<b>30,627</b>	<b>9.2</b>	<b>2,983</b>	<b>10.3</b>
<b>International mail.....</b>	<b>1,006,909</b>	<b>259,223</b>	<b>4.1</b>	<b>39,715</b>	<b>6.5</b>
<b>Total mail.....</b>	<b>180,888,060</b>	<b>23,352,386</b>	<b>2.0</b>	<b>1,800,085</b>	<b>14.6</b>
<b>Special Services:</b>					
Registry.....	16,254	N/A	N/A	N/A	N/A
Certified.....	288,018	N/A	N/A	N/A	N/A
Insurance.....	33,771	N/A	N/A	N/A	N/A
COD.....	4,708	N/A	N/A	N/A	N/A
Special delivery.....	139	N/A	N/A	N/A	N/A
Money orders.....	208,108	N/A	N/A	N/A	N/A
Stamped envelopes.....	N/A	N/A	N/A	N/A	N/A
Special handling.....	N/A	N/A	N/A	N/A	N/A
Post office box.....	N/A	N/A	N/A	N/A	N/A
Other.....	N/A	N/A	N/A	N/A	N/A
<b>Total Special Services.....</b>	<b>545,995</b>				

See accompanying notes.

UNITED STATES POSTAL SERVICE  
NOTES TO COST AND REVENUE ANALYSIS  
Fiscal Year 1997

**1. COST AND REVENUE ANALYSIS**

The Cost and Revenue Analysis (CRA) is prepared annually by the United States Postal Service (Postal Service) each year commencing October 1 and ending September 30 as an aid in determining that the Postal Service is meeting the statutory requirements under Title 39, U.S. Code, that "each class of mail or type of mail service bear the direct and indirect costs attributable to that class or service." The CRA presents estimates of the total and unit revenue of the categories of mail and services provided by the Postal Service during the year, as well as their estimated incremental and marginal costs. Such estimates are considered as one element of the Postal rate making process.

CRA data are based on information from the postal system of accounts. The postal system of accounts, however, generally does not accumulate financial data by class and subclass of mail. Apportionment factors are, therefore, required for development of the data for CRA purposes. These apportionment factors are derived from various postal operational and statistical information sources. Some of these, such as the In-Office Cost System and the Revenue, Pieces and Weight System, are dedicated to this purpose and involve extensive statistical sampling of postal activity during the year. New sampling procedures were partially implemented during Fiscal Years 1995 and 1996 for the Revenue, Pieces and Weight System to accommodate the effects of automation implementation. Coincident with implementation of these new sampling procedures, the difference between actual revenue as derived from the Postal Service financial systems and extrapolated revenue derived from the Revenue, Pieces and Weight System (before the routine adjustment for such differences) has increased. Management is continuing to refine and implement the new sampling procedures and explore further refinements and enhancements to sampling and expansion algorithms inherent in the Revenue, Pieces and Weight System. While extrapolated sample revenue should approximate actual Postal Service revenue, the system has been designed to accommodate and adjust for such differences, and the accuracy of apportionment factors used to develop per piece information does not necessarily depend on how close sample revenue are to actual revenues.

In 1997, the Postal Service changed its methodology used in estimating costs related to classes and subclasses of mail, and introduced estimates of incremental, volume variable and marginal costs. Development of such estimates included as one component the use of operational data included in the Management Operating Data System. The Postal Service also developed variability factors intended to estimate the relationship between increases and decreases in mail volume with associated changes in costs. Supporting information essential to the development of the CRA data is generally obtained from special studies. The methods employed to determine variability factors, incremental volume variable, and marginal costs are documented in the Summary Description and in testimony filed by the Postal Service before the Postal Rate Commission. The various criteria and methodologies utilized to develop the information presented in the CRA Report are available from Cost Attribution in Finance.

## **2. INCREMENTAL COSTS**

The incremental cost of a subclass of mail or service is an estimate derived from Postal Service cost models of the cost the Postal Service incurs as a result of providing the entire annual quantity of that subclass or service. Conversely, it is the estimate of the cost avoided by eliminating a product, assuming that all other products continue to be provided at their current volumes. The purpose of this cost category is to provide an indication of whether the customers of one subclass of mail (or group of subclasses) may be subsidizing customers of another subclass (or group of subclasses). Note, the incremental cost of a class of mail is greater than the sum of the incremental costs of its constituent subclasses. Class incremental cost includes common costs that are not caused by any one subclass alone but rather by the entire class.

## **3. VOLUME VARIABLE COSTS**

The estimated volume variable cost (sometimes called total marginal cost) of a subclass is the product of its volume and its marginal cost. The sum of the volume variable cost across all subclasses (total volume variable cost) is the revenue that the Postal Service would earn, at current volumes, if it priced each subclass at its marginal cost. Therefore, the difference between the Postal Service's total cost and its total volume variable cost represents the sum of dollars the Postal Service must earn by setting the price levels of its subclasses above their marginal costs, if the Postal Service is going to break even in a given year. For the year ended September 30, 1997 volume variable costs comprised 88.48% of all costs incurred by the Postal Service.

## **4. MARGINAL COST**

The Postal Service estimates of the marginal cost of subclass or mail category is the change in cost that results from a small change in its volume alone, with the volumes of other subclasses or mail categories remaining constant.

## **5. CONTRIBUTION MARGIN AND COST COVERAGE**

The relation of unit revenue to marginal cost provides a measure of the contribution earned by a subclass or mail category at the margin of production. The measure indicates the rate at which a given subclass offsets all other costs of the Postal Service. The contribution margin percent column gives the same information as a proportion of revenue per piece. The cost coverage column expresses unit revenue as a percentage of marginal cost.

## **6. FEES**

Fees associated with a specific class or subclass of mail are included in the reported revenue for that class or subclass.

**7. MISCELLANEOUS ADJUSTMENTS**

The following differences exist between the revenues shown in the Fiscal Year 1997 Annual Report of the Postal Service (AR) and the Fiscal Year 1997 CRA:

- a) The money order float of \$54.8 million included with interest income in the AR is included with special services revenue in the CRA.
- b) Mortgage income of \$0.8 million included with interest income in the AR is reported as miscellaneous revenue in the CRA.
- c) Reconciliation with the Annual Report of the Postmaster General (page 45):

(dollars in millions)	
Per the Annual Report	Per the Annual Report:
Operating revenue	Operating expenses
Interest income	Interest expense on borrowings
\$58,219	Imputed interest on retroactive assessment of employee benefits
115	POD Worker's compensation expense
	Interest Expenses on unfunded retirement liabilities
	<u>1,597</u>
	Total costs per the CRA Report (page 2)
	<u>\$57,066</u>

Total revenue per the CRA Report (page 2) \$58,331

**8. INTERNATIONAL MAIL**

International mail costs include costs of both U.S. origin and foreign origin mail. Volume statistics, however, do not include foreign origin mail.

**9. MISCELLANEOUS ITEMS**

Miscellaneous items include philatelic sales, fees, fines, unclaimed money from dead letters, sales of services performed for government agencies and private contractors.

**10. ALASKA AIR TRANSPORTATION**

The Postal Service spent \$112.9 million on air transportation within the state of Alaska. \$93.5 million of this total was provided for parcel post mailers. Alaska Bypass mail cost \$53.9 million. The Postal Service realized \$9.9 million in revenue from Alaska bypass service.

**11. OTHER**

All figures in the CRA are rounded; detail may not add to totals. Percents are rounded to the nearest decimal.  
- Denotes zero values.  
( ) Denotes negative values.

**12. PRODUCT SPECIFIC COST**

Of the incremental cost of certain subclasses, a portion consists of product specific cost. Those amounts are as shown below (in millions):

First Class Cards	\$11.3
Priority Mail	308.3
Express Mail	234.8
International Mail	84.4
Money Orders	45.9

**13. CARDS**

Volume variable cost includes \$3.9 million for stamped cards' printing cost.

**14. SPECIAL SERVICES**

Excludes ancillary service revenue.

## PREPARED STATEMENT OF MR. HENDERSON

Thank you and good morning Mr. Chairman, and Members of the Subcommittee. With me is the Vice Chairman of the Postal Service Board of Governors, Einar Dyhrkopp. We're pleased to be here today and welcome the opportunity to speak with you about the proposed "International Postal Services Act of 1998."

Mr. Chairman, I appreciate that you took the time to discuss this legislation with me last month. I believe the dialogue we've begun will lead to a solution that resolves the concerns behind S. 2082 and protects the best interests of the Nation and America's mailers.

When you introduced this legislation, you raised two questions. One, "Do international mail services pay their own way?" And two, "Should Congress put international rates under the jurisdiction of the Postal Rate Commission, as they did with domestic rates in 1970 when the Postal Service was created?"

The answer to the first question is yes. International services do pay their own way and more. As you pointed out when introducing the bill, cross-subsidies between different classes of mail are prohibited under postal ratemaking statutes.

In each rate case, the Postal Service must demonstrate to the Postal Rate Commission that total international revenues exceed total international costs. This ensures that domestic services, such as First-Class Mail, are not cross-subsidizing international ones.

The law also provides a remedy to those who believe the Postal Service is charging domestic rates that don't conform to these requirements. They can file a complaint with the Rate Commission, which has jurisdiction to investigate and recommend remedial action to the Governors of the Postal Service. This remedy, in conjunction with the ratemaking process, makes it unlikely that an actual cross-subsidy could be established or survive.

Our performance bears this out. Our international business has run a surplus in each of the last 5 years. Last year, fiscal year 1997, we grossed \$1.61 billion from our international business. Attributable costs were \$1.34 billion. The surplus was \$273.2 million. These results have been certified by independent auditors. Consequently, rather than customers paying higher domestic rates to support international services, international services are making a contribution to our overhead that helps keep domestic rates down.

I believe these facts and the established safeguards are a compelling response to the cross-subsidy issue. Nevertheless, in view of the Subcommittee's interest, we're taking further steps. The Board of Governors has asked the Inspector General of the Postal Service to conduct an audit of the allocation of costs between the Postal Service's domestic and international products and services. Their findings will be reported to the Board and to you. This will provide an objective, factual foundation for answering the cross-subsidization issue. If any weaknesses emerge during this review, you have my assurance that the Postal Service is willing and ready to work with you to correct them.

That brings us to the second issue—whether international rates should be placed under the domestic price setting system. As you might expect, we firmly believe the answer is no, for three reasons.

First, unlike domestic letter mail, our international postal business is not protected by the Private Express Statutes. Everything we do in this field is subject to marketplace competition. The market is the driving force regulating international postal services.

Any party whose prices were subject to regulation would be at a unique disadvantage. In our case, it would take 10 months to change prices. In addition, closely-held proprietary information on markets and pricing strategy would be an open book to other firms and hundreds of other postal administrations.

Second, we're not dealing with a single, uniform market, but hundreds of marketplaces. Each has its own laws, customs, and market nuances. For example, in Germany, Deutsche Post plans to go public in the year 2000. While in China we're dealing with a state-run institution with complex bureaucratic overhead. In every country, circumstances are different. Transportation costs vary from border to border and change constantly. Currencies fluctuate daily. Tariffs and entry requirements can be revised at any time. This places a premium on our ability to act quickly and to tailor specific customer solutions under widely varying conditions.

Further, the domestic ratemaking process wasn't designed to handle the unique requirements of international mail. It would create an administrative nightmare for regulators. We have about 10 products and services that go to hundreds of countries. There are 189 postal administrations represented at the Universal Postal Union alone. The actions of these nations determine about half of international mail costs, in the form of "terminal dues" we pay them to deliver U.S. origin mail on

their soil. We have limited influence on these costs, which are driven by the internal dynamics in the individual countries.

My third point is that none of this would be in the best interests of customers. It would tend to drive us out of the international marketplace and deprive consumers and businesses of all sizes of a valuable service alternative.

Under current law, we have used flexibility in international services to design and implement Global Package Link—a service that helps American companies sell to individual customers abroad. We have negotiated service agreements that meet special price or service needs of a variety of mailers. In every case, we have opened doors to foreign markets for American customers by providing them choice and value.

Placing international services in a domestic ratemaking format would take away our flexibility. As I mentioned earlier, postal rate proceedings typically take 10 months to complete. In addition, the negotiated service agreements customers expect in international markets are not available before the Postal Rate Commission. Without them, we would expect to lose a large number of valuable customers. But more to the point, they would lose us.

For these reasons, the Postal Service strongly believes that the approach taken in S. 2082 goes well beyond what might be needed to resolve the issues it's intended to address. Nevertheless, we're ready to do our utmost to debunk the allegations of cross-subsidization to the full satisfaction of this Subcommittee. We ask however, that in doing so, we do not compromise the ability of the Postal Service to serve its customers or to remain viable in world markets.

We are entering a new era of globalized postal services. Foreign postal administrations are buying private delivery firms. They're setting up shop in other nations. That includes right here at home. We believe it is imperative that the United States Postal Service retain its ability to respond. We are the bridge between universal mail service at home and international markets. This Nation and our customers need that bridge to remain strong, open, and toll free.

That concludes my prepared remarks. Vice Chairman Dyhrkopp would now like to make a statement.

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#### PREPARED STATEMENT OF MR. DYHRKOPP

Mr. Chairman, I am pleased to be here with Postmaster General Henderson to discuss the international mail services of the United States Postal Service. As the Vice Chairman of the Board of Governors of the Postal Service, in the absence of Chairman Winters who is out of the country on personal travel, I want to lend the support of the Governors to the Postmaster General's statement before you today.

I also want to assure you and the other Members of your Subcommittee that the Board of Governors take very seriously our oversight responsibilities as well as our role in the rate making process. As you know, this takes on even greater significance in the international mail area where the Postal Reorganization Act authorizes the Postal Service to set international rates.

Mr. Chairman, with that in mind, I would like to take a step back in history. The Postal Service authority over international mail bestowed by the Nation's first Congress was continued under the Postal Reorganization Act. In creating the Postal Service in 1970, the Congress divested itself of the practice of Congress setting domestic rates. Instead, Congress established shared responsibilities for setting these domestic rates in the Postal Rate Commission and the Postal Service. However, it also left in place the century old practice of having the Postal Service set the international rates. Indeed, Section 403 of the Postal Reorganization Act specifically directs the Postal Service to arrange for the delivery of written materials and parcels "throughout the world," and to provide such other incidental services as it finds "appropriate to its functions and in the public interest."

As the postal administration of the United States, with the authority over international mail and rates, the Postal Service is also uniquely suited to represent the United States at the Universal Postal Union, where it can and has dealt directly and effectively with the postal administrations of other countries.

In fact, the Postal Service is a leader in the Universal Postal Union. The Postal Service has taken a leading role in important UPU work, and has been effective in assisting the UPU to be more responsive in a rapidly changing world.

The question as to whether international rates should be placed under the domestic price setting system is troubling to the Board. Here again the Postmaster General has laid out several compelling arguments as to why the present system is in the best interest of the American public, with which the Board agrees.

With the international arena largely a deregulated environment, the Postal Service faces serious competition. The Postal Service is but one of many customer choices including several domestic private courier services.

In addition, several foreign postal administrations have set up shop here in the United States and are aggressively competing for the international business. All of these domestic and international competitors are unregulated.

The Board is very concerned over the allegations that international mail services are being cross-subsidized with Postal Service domestic products and services. The Postmaster General very effectively communicated that this is prohibited under existing ratemaking statutes. We have been assured by management in discussions on international mail services that will not occur.

We now have the benefit of a certification by an outside CPA firm, retained by the Board of Governors, establishing that domestic does not subsidize international rates. There is an additional layer of protection in having a firm independent of the organization certify the accuracy of costing and revenue data.

Nevertheless, the Board has also taken a further step to address the allegations which gave rise to this bill. We have asked the independent Inspector General of the Postal Service to conduct an audit into the cost relationships between domestic and international postal services.

Their findings will be reported to us and made available to you. This should provide an objective review and a factual foundation for answering the cross-subsidization question. As the Postmaster General has indicated and we fully support, the Postal Service is willing and ready to work with you to implement practical solutions to any problems that emerge.

Mr. Chairman, in closing, I want to assure you and the Members of the Subcommittee that the Board of Governors of the Postal Service were unanimous in our selection of Bill Henderson as our new Postmaster General. We look forward to working with Bill and fully support him in his future direction of the Postal Service.

Mr. Chairman, that concludes my prepared remarks. We will be happy to answer any questions at this time.

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#### PREPARED STATEMENT OF MR. McCORMICK

Chairman Cochran and Members of the Subcommittee, my name is Christopher McCormick. I am Senior Vice President of Advertising and Direct Marketing for L.L. Bean, Inc. I appreciate the opportunity to appear before you today to address concerns we have with S. 2082 and its impact on customers of the United States Postal Service's Global Package Link (GPL) service.

L.L. Bean is the largest outdoor specialty catalog marketer in the United States. We are located in Freeport, Maine where the company was founded 86 years ago. Our 1997 sales exceeded \$1.1 billion to customers in the United States and in over 150 countries worldwide. Approximately 10 percent of our revenue is derived from International sales. The focus of our International business is Canada, United Kingdom and Japan with the Japanese business constituting about 90 percent of overall International revenue.

A key to competitiveness for direct marketing businesses is the availability of high quality and low cost parcel shipping and catalog delivery services. For L.L. Bean, these costs constitute over \$100 million dollars annually. More than \$40 million dollars is related to delivery costs for catalogs and other forms of customer communications. The remainder represents costs for domestic and international package shipping and delivery. The success of our business is highly dependent upon effective partnerships with the USPS and commercial parcel shippers.

Fortunately, the U.S. market is well served by high quality and competitive commercial shippers including those represented here today—FedEx and UPS, as well as, a national postal service with a dedication and commitment to its customers.

L.L. Bean has enjoyed excellent relations with each of these organizations over the years. FedEx is today our preferred carrier for our domestic package delivery. Both the Postal Service and UPS, have handled this business in the past. USPS, through Global Package Link (GPL), services our Japanese parcel and catalog delivery needs and of course, delivers our domestic catalogs.

In sum, L.L. Bean, the direct marketing industry and in turn, the Nation as a whole, are well served by these quality companies and worthy competitors.

L.L. Bean believes that careful deliberation and extreme caution are called for in any changes contemplated by Congress that might effect the competitive playing field in the parcel delivery industry.

In L.L. Bean's experience, healthy competition in the industry has been the impetus for service innovations, improved customer focus and lower costs. Particular cus-

customer needs, or market niches, are best served by different companies at varying points in time, and individual company strengths and their competitive edges, evolve and change over time.

By way of illustration, I would point to L.L. Bean's experience in our relationship with FedEx for domestic package delivery. In 1993, FedEx developed an exclusive package delivery service for L.L. Bean. This new service made available superior tracking and tracing capabilities that allow our customers to know the status of orders in route to delivery. We were able to implement this new service while holding the line on costs and reducing delivery times. Today an equivalent level of service is broadly available in the market and serves as the standard for domestic package delivery.

Similarly, in 1994, L.L. Bean identified a need for a break-through in costs and quality of service for our international customers. This need was driven by our growing business in Japan. Customer research told us that we could not sustain or grow this business over time without major modifications to existing practices. The most significant issue the research identified was the need to reduce shipping charges and delivery times.

To place this issue into context, L.L. Bean has traditionally served our international customers through a cross-border mail order business model. We accept orders through the phone, mail or fax at our Freeport location and ship packages from Freeport to our international customers. As our Japanese business experienced more rapid growth, we chose to serve this market through the existing business approach with additional service enhancements. This business model allows L.L. Bean to leverage our customer service, order fulfillment capacities, and talented workforce in Maine as opposed to investing in in-country facilities and labor.

From an U.S. trade perspective this approach allows companies to operate in foreign markets from a domestic base thereby contributing to the health of the U.S. economy by generating domestic investments and jobs. However, for this approach to succeed the costs of package delivery represents a substantial barrier to overcome.

The USPS responded to our needs for lower costs and reduced shipping times with their proposal in 1994 to handle our business to Japan through a new service they had developed known as Global Package Link (GPL). We chose the USPS proposal over five others received through a competitive review process. The GPL offering reduced our 1994 delivery costs per package by approximately 50 percent, while reducing delivery times from 2-3 weeks down to 5-7 days. The USPS offering also met the critical test for universal service to all households in Japan.

While the details of the competing proposals we considered are protected by confidentiality agreements, I can tell you that the costs varied widely. One carrier's proposal was very close in price to USPS, while the others ranged from two-thirds higher to more than double the GPL offering. All carriers were able to meet our delivery time standard but the Postal Service product provided the greatest certainty of universal household service within Japan.

GPL has worked well for L.L. Bean over the three years it has been in place. Indeed it has become vital to the continued existence of our cross border mail order business in Japan. This business experienced rapid growth in the early 1990's at a time in which our catalog was a unique offering to Japanese consumers and the dollar-yen relationship was most favorable to mail order products priced in U.S. dollars. Since 1994 the change in the exchange rate has caused our products to experience a relative price increase of over 50% as compared to goods priced in yen.

Additionally, L.L. Bean catalogs are no longer unique to Japanese consumers. The Japanese consumer now has an unlimited choice of mail order offerings from U.S. and Japanese mail order companies and from a wide array of world wide mail order competitors. Many of these competitors have chosen to serve this market by investing in in-country facilities and capacity, including several well-known U.S. companies. Naturally, catalog businesses with in-country facilities have shipping cost advantage, and catalog customers in Japan are becoming increasingly sensitized to shipping rates.

Not surprisingly our customer research bears out this heightened consumer sensitivity to catalog shipping charges. "Have to pay too much for delivery" is the most cited problem with 48% of respondents in a recent customer survey identifying this as an issue. Sixteen percent of those customers indicated that they were "likely to not" purchase from L.L. Bean due to this issue and a full 68% indicated that they "may not" repurchase.

From these findings, we estimate that the high cost of shipping may cost L.L. Bean \$3.6 million to \$15.1 million in 1998 sales.

It is clear that existing catalog customers in Japan are dissatisfied with the current cost of shipping from the U.S. to Japan. Not reducing existing rates will cause

significant market loss. Increased shipping rates would jeopardize the existence of L.L. Bean's direct sales to Japan and our international business unit.

While this business has been impacted by other factors including the unfavorable dollar-yen relationship, increased competition and the overall decline of the Japanese economy, shipping charges remain the most vital factor to keep companies like ours in the business of cross border mail order shopping. I am sure that other customers of the USPS's GPL service can describe similar impacts on their businesses in Japan as well as other countries.

The struggle between the USPS and the commercial parcel shippers over the Postal Service's role in international shipping has implications well beyond which competitor obtains this business. Given the extreme sensitivity of mail order customers to shipping charges, the outcome of the current struggle could determine whether this form of direct foreign sales survives and grows or slows to a trickle.

There are two alternatives to its survival. One is the further movement of U.S. direct marketers away from serving foreign customers from a domestic base toward an in-country business model. This may require significant capital investment. Investment that could have been made in the domestic market.

The other alternative is for U.S. companies to abandon the business to global competitors that are able to effectively address the shipping cost issue through more cost effective postal or commercial carrier arrangements available through their host countries. This would represent not only a loss to U.S. mail order firms but to the economy as a whole through erosion of domestic jobs and investment.

I am aware of the variety of issues and challenges the competitors of the USPS have raised to the continued role of the Postal Service in serving the international package delivery market. I would not claim that L.L. Bean as a customer of the USPS is qualified to independently examine in depth each of the claims. We have, however, participated in a General Accounting Office review of some of the issues. This study is due out very soon.

We are also aware of the specific claims that give rise to the amendment you are considering here today, i.e., that the GPL service is cross-subsidized by monopoly mail thereby allowing the USPS an unfair competitive advantage.

Again we are not privy to the USPS cost-justifications for the prices they charge but we have reviewed this question with USPS officials. We have been assured that this service is not cross-subsidized and can not be cross-subsidized under existing law.

As I stated earlier in this testimony, from our experience different competitors in the package delivery business tend to serve specific business needs or market niches better than others at different points in time. The USPS has a history of serving the specific customer need our current international package delivery business requires. The nature of our business calls for the foreign delivery of a high volume of relatively low value packages to individual residences. In contrast, USPS's commercial competitors for international delivery have historically served a market that requires the shipment of relatively higher value business parcels delivered in multiple packages to a single foreign business address.

We look forward to the day that mail order companies have a viable choice of shippers to service our international customers, at a price that will allow our business to survive and prosper. We are confident that this choice will emerge as it has in the domestic market but urge careful thought and cautious action, on the part of Congress in intervening in a way that disrupts the current balance among strong, healthy and vigorous competitors in the package delivery business.

Thank you for allowing me to address this Committee. I'd be happy to answer any questions you may have.

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PREPARED STATEMENT OF MR. SMITH

On behalf of the 170,000 employees of FDX and its subsidiaries, I would like to thank the Subcommittee for the opportunity to appear today and present our views on necessary reforms in U.S. policies towards international postal and delivery services. S. 2082 provides for reform in one very important area: Postal Rate Commission oversight of international rates. This is an effort that FDX has long supported. In addition, I urge this Subcommittee to consider two other corrections in current postal law. First, replace the Postal Service with a neutral executive department as the U.S. policy maker for international postal and delivery services. Second, apply laws that affect international trade to all competitive services equally whether they be private or postal. All three of these reforms are necessary to correct problems which were either unseen or ignored in the 1970 Postal Reorganization Act.

Rapidly changing technology and new business practices over the past 30 years have fundamentally changed the commercial environment of the Postal Service. In response, the Postal Service has become more and more aggressive in competing with the private sector. The 1970 act fails to provide ground rules for this competition. Today, all too often we find that a legal privilege originally granted the Postal Service as a shield to permit public service has become a sword that provides unfair competitive advantage. While we are ready to compete with anyone, including the Postal Service, the fundamental rule must be that when the Postal Service enters a competitive market, it leaves behind its governmental privileges and competes on the same terms as everyone else. Otherwise, both competitive and non-competitive markets are distorted, to the detriment of monopoly mailers, private competitors and the U.S. economy as a whole. These problems can be reviewed and addressed only by the committees of jurisdiction in Congress because, remarkably, the 1970 act failed to vest any Executive Department with continuing responsibility for policy issues in the delivery services sector.

I am here today to discuss reform specifically in international postal services. While balanced and comprehensive reform is required in both domestic and international services, there are some aspects of international postal policy where the need for reform is so urgent that we cannot wait for a comprehensive reform package. International postal policy is even more antiquated than domestic postal policy. When Congress reorganized the Postal Service in 1970, it was so preoccupied with the domestic issues that it paid virtually no attention to the international. International services are today the most important area of growth in our industry. Yet the governing legal framework lacks even the checks and balances introduced in the domestic sector in 1970.

In 1970, the Postal Service faced minimal competition in international services, and there was little temptation to overcharge monopoly mailers and undercharge competitive services or use governmental privileges for commercial ends. Today, the situation has changed radically. With improvements in long distance communications and transportation technologies, international delivery services have become more important and more diverse. Private express companies like Federal Express, UPS, and DHL have led the way in innovation and service quality. National post offices such as the Dutch and British have responded by "going global." A British postal official announced recently, "The forces of globalization are rendering obsolete the idea of a national postal market." Today, the total failure of the 1970 act to address international issues can no longer be ignored.

Again, there are three specific reforms in the international area that I believe need to be addressed in this session of Congress:

- First, regulatory oversight of domestic postal services should be extended to the international postal services as well.
- Second, the administration should be charged with responsibility for developing and promoting a pro-competitive, pro-U.S. policy for international delivery services just as it is for all other international services.
- Third, U.S. laws that vitally affect international trade, like customs laws, should apply equally to all competitive services.

I will explain each of these points briefly.

The case for the first point—extension of Postal Rate Commission jurisdiction—is obvious. The policy reasons for PRC jurisdiction in international markets are exactly the same as in domestic markets. In both cases, an independent check is needed to ensure that the Postal Service does not overcharge monopoly customers and use the money to subsidize rates for competitive services. The Postal Service itself recognizes these constraints should apply to international rates as well as domestic rates, but they have always resisted the idea of an independent check. The Postal Rate Commission should have the same authority to enforce these policies in the international market as in the domestic market.

The Postal Service has argued that Postal Rate Commission jurisdiction should not be extended to international services, because the international market is more competitive than the domestic market. If anything, this argument implies a greater rather than a diminished need for regulation; a higher level of competition provides a greater temptation to cross subsidize competitive services from the Postal Service's huge pool of monopoly revenues. The Postal Service has also said that the delays and costs of PRC review will make it more difficult to compete in international markets. This argument, however, in no way suggests that the protections afforded in the domestic market should be missing in the international market. This is an argument for improving and streamlining the entire regulatory process. Such a comprehensive reform plan is now under consideration in the House and supported by

FDX. The need for comprehensive regulatory reform some time in the future does not, however, undercut the need for extending the regulatory protections of the 1970 act to the international arena today. Another concern seems to be that oversight by the Postal Rate Commission may result in increased rates for certain international postal services. However, the Postal Service itself maintains that all international rates cover appropriate costs. If that information is correct, there should be no need for significant rate increases. All we want is an independent check of the Postal Service's claims. Even if the Postal Rate Commission were to find that some international rates are priced too low, the effect on large mailers must be seen in proper perspective. If the Postal Service is underpricing some services, it must be covering costs by cross-subsidizing from other products. Large mailers are big buyers of these other postal products. In other words, if a large mailer is saving money on some international rates, it is also probably paying for this practice through higher postage rates on letters or advertising mail. Overall, it is unlikely that large mailers realize significant net gains from underpriced international rates. Meanwhile, it is certain that underpricing international postal services creates market distortions that are damaging for all concerned. Underpricing markets is a strategy for discouraging investment and innovations.

In my view, there is no justification for the Postal Service deliberately undercharging any services, domestic or international. This is clearly the policy embodied in the 1970 act. The same procedures that prevent such abuses in domestic postal services should apply to international postal services.

Let me turn now to the second point—the need for a pro-competitive, pro-American trade policy towards international delivery services. Today, the Department of State, the Department of Commerce, and the U.S. Trade Representative work together to promote free and fair trade in international services. This policy serves the best interest of the United States, because the United States excels in sophisticated services. Recently, these efforts have yielded spectacular results in the telecommunications sector.

One type of international services, however, is missing from the trade-in-services mission of these Executive Departments: International postal services. Why? Because the 1970 act failed to shift authority to represent the United States at inter-governmental organizations from the business-like Postal Service to an Executive Department which represents all social and business interests of the United States generally. The resulting conflict of interest is an anomaly in American diplomacy. It's as if AT&T were responsible for U.S. telecommunications policy or United Airlines for international aviation policy. Important negotiations at the Universal Postal Union, the World Customs Organization and the World Trade Organization are imminent. Yet the trade-in-services machinery of the U.S. Government has so far paid no attention to these negotiations which are crucial to the future of our industry.

Not only is the combination of diplomatic and operational authority in the Postal Service unique in American law, it is increasingly becoming an anachronism at the Universal Postal Union itself. Today, most developed countries are represented at the UPU by two types of officials, "regulators" and "operators," each with distinctly different responsibilities. At the UPU, regulators from countries such as Germany and the Netherlands are taking the lead in proposing institutional reforms that will better separate commercial and governmental functions. Meanwhile, the United States is one of the last major countries to send an operator to represent the government itself.

In suggesting that an Executive Department should represent the United States at inter-governmental organizations, I am not suggesting the Postal Service should lose the power to negotiate operational agreements with foreign postal services. I would like to emphasize this point. As far as FDX is concerned, the Postal Service should have the same authority to negotiate with foreign post offices as FedEx has to deal with foreign companies. Perhaps nine-tenths of the current Universal Postal Convention would be considered operational in nature and left to the commercial discretion of the Postal Service. However, when an international agreement requires the status of international law—when it constitutes an obligation of the United States as distinct from the Postal Service—then such an agreement should be negotiated and concluded by an officer of an Executive Department and not by a "business-like" Postal Service.

Let me give you a simple example. The Postal Service and other postal officials at the UPU have agreed on a simplified international customs form for shipments valued at \$400 or less. It looks like this [Customs Form CN 22]. The shipper, not the post office, is responsible for filling out this form. Postal services are generally not required to provide the number of dutiable packages shipped through the post nor do they generally give advance information on the shipments. The UPU Conven-

tion also exempts post offices from liability for Customs misdeclarations and any obligation to post customs bonds.

Meanwhile, when a private express carrier handles the same types of shipments, it rather than the shipper is responsible for all customs documentation. The customs information required is far more detailed and complicated and presented in advance of the shipments arrival. We are also liable for any customs misdeclarations and must post adequate bonds to cover this liability. Customs can choose the shipments it wants to see, and we present those shipments when the flight arrives. We also pay all duties and taxes owed before the shipments are released so that full duties and taxes are paid on 100 percent of all our dutiable shipments. If a private express carrier were to deliver packages after performing the minimal procedures required of a shipment coming in through the post, it would be subject to fines and penalties. Just to put that in perspective, I have here an average size manifest for one flight which contains approximately 7,000 shipments. If we followed the process for foreign postal shipments coming into the United States, we would be subject to fines and penalties up to the total value of the shipments, which, assuming an average value of \$200 would amount to a \$1.4M penalty for that one flight.

The correct customs policy should be a matter for the U.S. Government, not the Postal Service, to decide. We strongly support customs simplification and believe it is in the best interest of our industry as well as the shipper. Shippers should have a choice of carriers who can use simplified customs procedures. It is simply not right for the Postal Service to use the diplomatic power of the United States to promote international agreements that limit such privileges to postal shipments.

This example leads directly to my third point—Customs laws are the single greatest impediment to expansion of international delivery services. Unduly rigid and detailed customs regulations impede all types of traffic, but as is apparent from the above discussion, they weigh more heavily on private shipments than postal. It is simply for historical reasons that postal shipments have access to the simplified procedures suitable for commercially insignificant shipments while the same shipments by private carriers are burdened with customs procedures developed to regulate cargo carried by sailing ships.

The development of truly global delivery services will bring to the international economy the same enormous benefits that national delivery services have brought to the national economy. Such services will be impossible, however, until customs procedures are greatly simplified for all. This day will not come so long as a large and politically powerful class of operators, the post offices, have a commercial interest in blocking across-the-board customs simplification. FDX and other private carriers have spent more than a decade working for customs simplification at the World Customs Organization. While we have made progress, without the support of the post offices we will never be able to persuade customs officials of the need for really fundamental simplifications.

The only solution to this impasse is to apply the customs laws equally to all operators for competitive services. By this, I do not mean a one-size-fits-all approach. Different levels of customs procedures may be appropriate depending upon the nature and value of a shipment, the extent or advance of computerized documentation, etc., by "customs equality," I only mean that all levels of customs procedures should be equally accessible to all types of carriers when tending similar shipments for customs clearance.

I know there are some who say that a U.S. policy of equal customs treatment for postal and private shipments will deprive U.S. shippers of desirable international postal services like Global Package Link. Not only does this contention ignore the rights of private carriers, it also lacks rationale basis. If the United States had such a policy, why would a foreign country who was already allowing importation of a large quantity of U.S. goods under simplified customs procedures continue to restrict such imports to a single U.S. operator in defiance of this U.S. policy? It would lose nothing by allowing simplified clearance for all U.S. operators under similar conditions. On the other hand, by denying simplified clearance to U.S. carriers, a foreign country will make it more difficult for its citizens to import American goods, and it will run the risk of the U.S. retaliation. The United States could certainly respond by withholding simplified customs treatment for postal shipments exported to the United States from such country, especially considering that the foreign country will, in effect, be favoring foreign post offices over all U.S. carriers. What foreign country would want to start a trade dispute of such magnitude over a mere formality?

I am convinced that true worldwide customs simplification must await equal customs treatment for all operations. Post offices and others who seek to preserve simplified customs processing as a special privilege of post offices are the opponents,

wittingly or not, of genuine customs reform and the evolution of efficient, global delivery services.

FDX certainly supports S. 2082, because it implements one of the three points that I have noted, extension of Postal Rate Commission jurisdiction to international mail. On the other hand, we feel strongly the other two points, a neutral U.S. international postal policy and customs simplification, are absolutely crucial to achieve even a minimal level of reform in U.S. international postal policy. Both of these issues are a critical juncture where immediate and decisive action by the United States is urgently needed.

Thank you again for the opportunity to prevent the views of FDX.

#### PREPARED STATEMENT OF MR. KELLY

Good morning, Mr. Chairman and Members of the Subcommittee. My name is Jim Kelly, and I am the chairman and CEO of United Parcel Service.

I appreciate the opportunity to discuss a topic that is of foremost importance to me, our company, and the 330,000 people we employ worldwide. The need for meaningful reform of the U.S. Postal Service has never been more clear or more timely. I applaud your efforts here in this subcommittee and commend your colleagues in the House, who are also working diligently to examine the role of the Postal Service in today's competitive marketplace.

We fully support this legislation. The proposal addresses a serious problem: the fact that the Postal Rate Commission currently has no oversight authority on international postal rates and services. In effect, the current limited jurisdiction that the PRC has over the Postal Service stops at the water's edge. That leaves this government agency free to do internationally what they are prohibited from doing domestically. No other government agency operates without basic oversight over its international activities.

Commission oversight is particularly important because the Postal Service is increasingly using its government status and advantages to undermine free market practices both here and abroad. We contend the Postal Service is using revenue from its monopoly to subsidize products that compete with the private sector, including international services.

This abuse of the monopoly has a direct impact on American consumers, who are now being forced to pay significantly more for first-class postage than they otherwise would. Why is the Postal Service asking for another billion dollars every year through the penny increase on the price of a monopoly stamp when they have generated more than a billion dollars in surplus every year for the past three years and are doing so again this year? Is the Postal Service truly planning to improve service and focus on its mandate of universal letter mail service, or is the agency going to use this revenue to subsidize international and domestic services that compete unfairly with the private sector? We suggest it will be the latter.

If the Postal Service were truly committed to its mandate of providing universal letter mail service, why is it entering into numerous other activities wholly unrelated to this mission? The Postal Service is now processing bills, selling mugs, T-shirts and hats, and is hawking telephone cards. What does this have to do with delivering the mail? Absolutely nothing. In fact, it forces the Postal Service to lose focus on its primary mission.

We believe a first step toward rectifying this problem in the international arena is to give the Postal Rate Commission the power to set international rates and services. The result will be more fair and equitable rates because for the first time there would be a real relationship between actual costs and international postal rates. If the playing field is leveled, the Postal Service will be forced to look harder at its primary mandated goal of providing efficient universal delivery of letter mail.

Let me give you some examples of how the Postal Service is currently operating in a manner that is anti-competitive and anti-free enterprise. As a government agency, the Postal Service enjoys numerous advantages that no private company is permitted. I'm sure that you and the other Members of the Subcommittee have heard the exhaustive list, but permit me to give you a few highlights. The Postal Service pays no income taxes—Federal, State, or local. It enjoys unfair customs advantages. It is immune from motor vehicle licensing fees for the hundreds of thousands of vehicles it operates on our Nation's highways. It is not subject to OSHA enforcement. And the Postal Service can borrow at favorable interest rates because the federal government backs its debts.

But the biggest advantage of all is that the Postal Service is able to use its legally sanctioned monopoly like a weapon against its competitors. The Postal Service amasses about \$60 billion dollars every year in revenue, and about \$50 billion of

this comes from its monopoly—which is protected from effective competition. We are all familiar with the phrase that “Power corrupts and absolute power corrupts absolutely.” That is certainly true of monopoly power.

Let me give you an example of how the Postal Service is able to use its monopoly unfairly in the international arena. The Postal Service charges \$26.63 to ship a 10-pound package via its Global Package Link service from San Francisco to London. That’s \$3 dollars less than they charge to ship that same package via Express Mail from Washington, D.C. to Baltimore. Common sense dictates that it can’t cost less to send a package overseas than to send it domestically.

During a recent appearance at the National Press Club, former Postmaster General Marvin Runyon tried to explain this anomaly by saying it was an apples to oranges comparison because the GPL rate applies only where the shipper sends 10,000 packages overseas. That explanation is disingenuous at best. It implies economies of scale. What the Postmaster General did not say is that in order to get the cheap GPL rate, the shipper need only send 10,000 packages over the course of an entire year to all or any of the 11 countries where GPL service is available. It doesn’t take an economist to know that any cost savings in the case of large volume shipments exist only when the large volumes are shipped at one time to one place, and not in bits and pieces over the course of a whole year to different destinations.

So, how can the Postal Service afford to charge one-quarter of what the private sector charges for these international shipments? It can’t. The Postal Service is subsidizing the cost of its international competitive services, and of other competitive services, from the revenues it makes on its letter monopoly.

I have no doubt that we would uncover other instances where the Postal Service is unfairly undermining its competition on international rates—if only the data were publicly available. However, the Postal Service has consistently refused to expose to the light of day any meaningful cost and rate information on its individual international services. That is unacceptable in the case of a government agency. In this era when even the CIA is being forced to declassify sensitive information at record speed, you would think the U.S. Postal Service could come clean on its international costs. This refusal to make the information available for public scrutiny leads naturally to the question, “what does the Postal Service have to hide?”

This is an example of why the Postal Rate Commission must be strengthened both domestically and internationally. In fact, the PRC itself has told Congress that it needs more oversight authority precisely because the Postal Service is competing more and more with the private sector.

The bill before you would go a long way toward assuring Congress and the American public that the Postal Service would not be able to abuse its monopoly power. By giving the Commission the same jurisdiction over international postal rates paid by American citizens as the Commission has with respect to domestic postal rates, Congress would dispel some of the questions now being raised. And a fair and rational rate setting process will foster true and open competition in the global marketplace.

In fact, additional changes are also needed to make Commission review fully effective, both internationally and domestically. The Commission should be given subpoena power, and its decisions should be made final and binding, subject only to judicial review, rather than being reviewed by and subject to modification by the Postal Service through its Governors.

I would not be before you today if the Postal Service were focusing on its primary mission of delivering first-class mail. Unfortunately, the Postal Service is using its government advantages to systematically and unfairly undermine its private sector competitors. We do not object to free and open competition. In fact, we embrace it because it makes us a stronger, smarter company. But we vehemently object to unfair competition on an unlevel playing field where government-granted advantages are used like a weapon in the marketplace. Your legislation will take a meaningful step in the right direction by helping to level the playing field internationally.

Thank you for this opportunity to testify on this important subject. Mr. Chairman, I request that my written remarks be submitted for the record. Thank you. I would be happy to answer any questions Members of the Subcommittee might have.

## PREPARED STATEMENT OF DHL WORLDWIDE EXPRESS, INC.

*I. Introduction*

DHL Worldwide Express, Inc. ("DHL"), the U.S. arm of the DHL Worldwide Express Network (the "Network")<sup>1</sup>, appreciates the opportunity to comment on S. 2082, the International Postal Services Act of 1998. The Network employs over 59,000 people, serves 226 countries and generates over \$6 billion in annual revenues. As the world leader in the international transportation and delivery of time-sensitive business documents and parcels, DHL strongly supports this legislation, which would subject international postal services to review by the Postal Rate Commission ("PRC").

DHL has previously testified before Congress on comprehensive postal reform issues and wishes to commend Chairman Cochran and the Subcommittee staff for addressing an important element in regulatory reform involving international postal services. Extension of PRC jurisdiction to international mail products, however, is but one of three essential elements required to provide a level playing field between the U.S. Postal Service ("USPS") and private international delivery companies.

In order to ensure fair competition between USPS and private express carriers in the international delivery market, DHL believes that S. 2082 should be amended to include:

- Provisions to establish a clear separation between the regulatory and operational functions of the U. S. Postal Service ("USPS") with respect to international postal services, including (i) repeal of USPS' authority to regulate or discriminate against its private competitors through its suspension power under the Private Express Statutes, and (ii) elimination of the inherent conflict of interest posed by USPS' representation of the Federal government's interest in international policy-making bodies such as the Universal Postal Union; and
- Provisions to ensure equal application of the laws—including equal application of the anti-trust and customs laws—to international delivery services provided by the USPS in direct competition with private firms.

These elements would help ensure fairness in the international delivery sector by restricting the ability of the USPS to employ its quasi-governmental status and special legal privileges to discriminate against, and compete unfairly with, private international delivery companies. International postal reform legislation which includes these important additional provisions is now being considered in the House of Representatives. As explained more fully below, DHL strongly urges inclusion of these provisions in Senate postal reform legislation as well.

*II. DHL and the International Air Express Industry*

DHL specializes in the rapid, door-to-door transmission of time-sensitive business documents and small parcels in the United States and around the world. DHL is a fully integrated transportation and delivery company: it operates its own fleet of jet aircraft, helicopters and ground vehicles and also employs on-board couriers, scheduled commercial aircraft and charter planes. To facilitate clearance of international shipments, DHL maintains its own customs brokerage operation in each of its scheduled ports of entry in the United States. By exercising complete administrative control over each document or parcel from pick-up to delivery, DHL provides a level and quality of service that cannot be matched by the international services traditionally provided by the USPS, foreign postal administrations and other entities that lack technologically advanced tracking systems and whose administrative control over shipments stops at national boundaries.

In today's interdependent global market, the transfer of information has become as significant to the world's business as the transfer of goods and capital. Since their founding less than three decades ago, DHL and other integrated international delivery companies have played an increasingly essential role in the global economy. DHL provides international express document services primarily to service industries that compete in global markets—international financial institutions and corporations, legal and consulting firms, government entities, transportation and ship-

<sup>1</sup>The Network is comprised of essentially two completely separate corporate entities: one, DHL Worldwide Express, Inc., a Delaware Corporation, which, through its wholly owned operating subsidiary, DHL Airways, Inc., is responsible for pick-up and delivery (including air transport) of documents and packages originating in, or destined for, points within the United States and its Territories; the other, DHL International Limited ("DHLI"), a foreign corporation, which, through subsidiary and affiliated companies, performs these same pick-up and delivery functions for every point served by the Network outside of the United States and its Territories. DHL and DHLI act as delivery agents for each other in their respective regions.

ping companies, engineering and construction firms and multinational institutions. Among other things, international express delivery firms like DHL provide rapid and reliable delivery of sensitive financial instruments, bills of lading and corporate communications. At the same time, the private international air express industry is also playing a growing role in the manufacturing and distribution sectors of the economy. In particular, the industry today handles increasing volumes of time-sensitive small packages and heavier shipments of goods and parts for merchandisers, just-in-time manufacturers, and research and technology firms. These value-added delivery services greatly enhance the efficiency, cost-effectiveness and competitiveness of individual firms, national economies and the global market as a whole.

### *III. The Need to Reform Laws Governing International Delivery Services*

The Nation's outdated postal laws—enacted nearly 30 years ago—are ill-suited for today's dynamic market for international delivery services, in which sophisticated and technologically advanced firms provide fully integrated and critical delivery services to a wide array of global businesses. In drafting the Postal Reorganization Act of 1970, Congress failed to anticipate the development of the private express delivery industry and the competition it would create with USPS, particularly in the area of international delivery services. The 1970 Act, not surprisingly, failed to include any mechanism for review or oversight of USPS' international products as it did for domestic mail products. As a result, a regulatory environment was created where USPS is able to use its monopoly powers and quasi-governmental status to compete unfairly with the private express industry for international delivery business.

As explained in further detail below, current postal laws and practices: (1) fail to provide for effective PRC—or, indeed, any—oversight over USPS' international postal services and rates; (2) unfairly permit the USPS to regulate the terms of competition between itself and its private competitors in the international delivery market—a fundamental conflict of interest; (3) fail to assure that laws that regulate international commerce apply equally to directly competitive international services provided by the USPS and its private competitors; and (4) allow USPS to exploit its quasi-governmental status to obtain unfair competitive advantages overseas in its increasingly aggressive competition with private international delivery firms. DHL submits that a balanced and effective approach to international postal reform should address each of these deficiencies in current law.

#### *A. The PRC Lacks Jurisdiction Over International Services.*

Perhaps the most fundamental flaw in the 1970 Act is its failure to require PRC approval for USPS' international mail rates and products. The PRC's regulatory oversight of domestic mail services is intended to protect consumers and competitors against the abuse of USPS' monopoly power by ensuring that domestic mail products are fairly priced and cover attributable costs. These same concerns are no less important with respect to international postal services. Without effective rate review, there will always be a significant risk that USPS will use its domestic monopoly power to compete unfairly for international market share through predatory pricing, trade-distorting cross-subsidies from monopoly products, and anti-competitive tying arrangements.

In introducing S. 2082, Chairman Cochran noted allegations that the USPS uses its revenues from first class mail to subsidize its international postal services. The Chairman also noted, however, that the lack of PRC oversight over international mail under current law prevents Congress, competitors, and the general public from determining conclusively whether international mail is, in fact, covering its attributable costs and is fairly priced, as USPS contends. There is much troubling evidence, however, that USPS may, indeed, be providing cross-subsidies to its competitive international postal services. According to a recent report in *Business Mailers Review*, the data for international services in the 1998 Postal Service Marketing Plans differs from that reported in the 1996 Cost and Revenue Analysis and the 1997 Rate Case. According to the data in the Marketing Plans, the products of the USPS International Business Unit would cover barely 57 percent of attributable costs for such products.<sup>2</sup> Moreover, the marketplace provides growing anecdotal evidence of such suspect pricing practices. For example, USPS currently charges \$26.63 for shipping a 10 lb. parcel under its Global Package Link Service from San Francisco to London—\$3 less than the cost of shipping the same package via Express Mail between Baltimore and Washington, D.C.

<sup>2</sup>See, e.g., USPS, Revenue Pieces and Weight Reports; USPS, Cost and Revenue Analyses; Patelunas Testimony in R97-1 (Exhibits T-15E, J); 1998 USPS Marketing Plans (Oct. 1997).

Congress last overhauled the general postal law in 1970—only one year after the founding of DHL and years before the establishment of Federal Express and other express delivery firms. At the time, the limited competition provided by private on-board couriers services could hardly have presaged the multi-billion dollar express delivery industry of the late 1990's. The failure of the Postal Reorganization Act of 1970 to grant PRC jurisdiction over international services may have been viewed at the time as an innocuous oversight by Congress. As the private international express industry has grown and created genuine competition with USPS and foreign postal administrations, however, the effects of this oversight have become increasingly pronounced. There is simply no justification now for continuing to exempt the USPS from PRC regulatory oversight and accountability in its provision of international mail services. By harmonizing the PRC's jurisdiction over domestic and international mail services, S. 2082 would make an important contribution to a fairer and more pro-competitive regulatory environment for all international delivery services, including international postal services.

*B. Current Law Fails to Separate USPS' Regulatory and Operational Roles.*

The regulatory regime established under the 1970 postal law also failed to establish a clear separation between the regulatory and operational roles of the USPS. In particular, current law provides the USPS with undue advantages by allowing USPS to set the rules under which it also competes with private firms, particularly in the provision of international services.

DHL and other private delivery firms have repeatedly noted that their ability to compete in the world market is subject to the administrative discretion of the USPS, which, in effect, self-administers the postal monopoly laws. Under the Private Express Statutes, the USPS asserts a "monopoly" on the carriage of "letters and packets," both domestic and international, over any "post route" in the United States. Under postal regulations promulgated and enforced by the USPS, "letters and packets" are broadly defined to include all manner of commercial and business documents, provided that such documents are "addressed" to a specific person or "directed" to a specific address.<sup>3</sup> Any violation of this self-defined monopoly—by a carrier or user—can result in an injunction, fine or imprisonment, or any combination thereof.<sup>4</sup> In order to fend off Congressional legislation which would have limited the application of the Private Express Statutes to, and provided a more secure legal foundation for, the growing private express industry, the USPS unilaterally chose to "suspend" its asserted monopoly in 1979 over "extremely urgent letters" which meet certain "time of delivery" or "minimum pricing" requirements.<sup>5</sup>

Alternatively, a "letter" will be conclusively presumed to be "extremely urgent" if the amount paid for private carriage is at least \$3.00 or twice the applicable U.S. postage for a first class mail (including priority mail), whichever is greater. *Id.*

The suspension regulations, by their terms, require the interposition of the USPS in either the content or price of time-sensitive deliveries by its competitors. The current rules thus hold DHL and other international express delivery firms hostage to administrative exceptions granted, interpreted and enforced by a monopoly that is, at the same time, aggressively seeking to compete for their business. Such rules simply have no place in the commerce of the 1990's, in which global markets have already rendered a judgment on the commercial importance of this industry. While a substantial argument may be made that the Private Express Statutes have outlived their usefulness altogether, Congress, at the very least, should amend the postal laws to exclude competitive international services from the scope of the monopoly and thus free private express companies from regulation by a government-owned competitor.

Current law also authorizes the USPS to represent the United States at international congresses of the Universal Postal Union ("UPU") without effective direction from the President, Congressional oversight, or public participation. The inter-

<sup>3</sup>See generally 9 C.F.R. Part 310.

<sup>4</sup>39 C.F.R. 310.2.

<sup>5</sup>39 C.F.R. 320.6. Under the suspension regulations, the Postal Service permits the private carriage of "expressly urgent letters" if such carriage meets either a "time of delivery" test or a "minimum pricing" test. Generally a "letter" will be presumed to be "extremely urgent" if it is delivered to the addressee by 10 a.m. the next business day. Letters sent to jurisdictions outside of the United States are deemed "delivered" when they are in the custody of the international or overseas carrier at its last scheduled point of departure from the United States. Similarly, letters sent from foreign jurisdictions to the United States are deemed "dispatched" when they are in the custody of the domestic carrier after clearance by U.S. Customs. *Id.* The "time of delivery" suspension is available "only if the value or usefulness of the letter would be lost or greatly diminished if [the letter] is not delivered within these time limits." *Id.* (Emphasis added).

national express industry has repeatedly criticized this arrangement, under which USPS acts as the sole U.S. negotiator of international postal agreements while, at the same time, actively competing in the international delivery market. In view of this untenable arrangement (as well as the longstanding hostility of certain foreign postal administrations to the private express industry) it is hardly surprising that various UPU acts and policies impose discriminatory costs and burdensome regulation on the international private express industry. For example, Article 25 of the UPU Convention authorizes national post offices to intercept and return international “mail” that has not been posted by the country of dispatch. Other provisions permit non-cost-based interpostal charges, such as terminal dues, that allow postal administrations to manipulate international rates and thereby undermine private carriage. As with the fundamental conflict of interest inherent in its suspension power under the Private Express Statutes, it is equally unfair for the USPS to exercise such broad powers to shape the international regulatory environment under which it also competes with private express firms.

*C. Current Laws Are Not Applied Equally to USPS and its Competitors.*

A wide range of laws—ranging from antitrust to vehicle laws—are applied differently to the USPS and its private competitors. In many instances, this unequal application of the laws provides the USPS with unfair competitive advantages over its private-sector competitors. The effects of this disparate legal treatment are particularly pronounced where USPS and private firms provide directly competitive delivery services in the international marketplace.

In its providing competitive international services, the USPS—unlike its private competitors—can take advantage of numerous special legal benefits. These include claimed protections of sovereign immunity, exemptions from the antitrust and unfair competition laws, and preferential customs treatment. Under Part 128 of the Customs Service regulations, for example, private express delivery companies have numerous obligations that are not imposed on essentially similar USPS services. These include:

- the requirement to obtain Customs bonds for certain shipments and to undertake liability for customs duties, penalties and fines, when acting as “importer of record;”
- the obligation to make outbound and in-transit shipments available for Customs Service inspection;
- special manifesting, record keeping and automation obligations; and
- special training and security requirements.<sup>6</sup>

The USPS also benefits from gaps or ambiguities in U.S. customs practice. As a result of inadequate collection procedures, the USPS fails to remit to Customs substantial amounts of duties and fees, which it is obliged to collect. Due to its quasi-governmental status, the USPS is also exempt from Customs fines, penalties and liquidated damages. Moreover, unlike private delivery providers, the USPS does not reimburse Customs for services provided in processing international shipments.

Foreign legal requirements are also applied differently to essentially equivalent USPS and private delivery service shipments. As a national postal monopoly and quasi-governmental agency with exclusive access to foreign postal administrations through the UPU, the USPS often benefits from favorable foreign laws and practices unavailable to private competitors. These laws and practices in many cases provide the USPS with special customs rates; exemptions from duties, fees and taxes; preferential customs clearance and other special services; and favorable foreign taxes and other provisions designed to protect the national postal monopoly and other favored providers.

Such differences in legal treatment—whether based on tradition, practice, an outdated understanding of the international delivery industry or abuse of USPS’ quasi-governmental status—are fundamentally unfair when applied to essentially competitive international services and should be eliminated.

<sup>6</sup>While some obligations imposed on the private international express industry may be justified to assure that the Customs Service is able to meet its enforcement obligations while providing the necessary services to facilitate the expedited delivery of international shipments, commercial fairness requires that USPS should not be permitted to receive similar expedited customs treatment unless it assumes the same obligations as those imposed on private express companies.

*D. Congress Did Not Contemplate USPS' New Extra-Territorial Services at the Time of Enactment of the Postal Reorganization Act of 1970.*

The deficiencies in current U.S. regulation of international mail services have been highlighted by the various competitive international products introduced by the USPS in recent years. In 1995, for example, the USPS announced its intention to compete "aggressively" in the international market and to become a leading provider of efficient, high value, reliable and secure, full-service international communication and package delivery services. In implementing this policy, the USPS created an International Business Unit, introduced an array of new, value-added international services that go far beyond traditional international mail and, in some instances, has contracted with private foreign entities for delivery outside of the United States.

Historically, USPS and its predecessors delivered international mail to the sovereign boundaries of a foreign country, at which point the foreign postal authority took control of the mail, cleared it through customs and effected delivery. Unlike international express delivery firms, the USPS did not provide—and, indeed, was generally understood not to have the authority to provide—integrated, door-to-door express delivery across national boundaries, with central administrative control from the point of pickup to delivery.

International services introduced by USPS in recent years, however, represent a fundamental shift in the manner in which the USPS provides delivery services to foreign countries. For example, under its Global Package Link ("GPL") Service, the USPS is aggressively seeking to provide international merchandise delivery services which are modeled on, and compete directly with, the integrated delivery services provided by private express companies. Under the GPL program, the USPS employs its own designated customs broker for foreign customs clearance and employs a "delivery agent" for expedited, secure delivery with tracking in the foreign country. In effect, through the use of agents in the foreign market, the GPL program purports to provide integrated, end-to-end parcel delivery service identical to that provided by private express companies. Similarly, USPS has recently expressed interest in expanding its GPL service to include inbound "mail" shipments. Presumably this would require employment of a shipping "agent" on foreign soil who would coordinate pick-up, file advance customs documentation—or even provide customs pre-clearance—and ensure some measure of integrated control to the point of delivery in the United States.

DHL does not object to direct competition with USPS, but merely insists that such competition be fair and conducted on a level playing field. In repeated submissions to the USPS, the international express delivery industry has pointed out that the GPL service likely benefits from cross-subsidization from monopoly classes of mail and/or plain predatory pricing. In addition, the USPS is able to exploit its quasi-governmental status to obtain special privileges from foreign postal administrations. These including special customs rates; exemptions from duties, fees and taxes; and special services for "mail" products that enable USPS to provide sharply discounted prices and expedited customs clearance. (This special treatment is the apparent basis for USPS' claim that GPL provides the "fastest clearance" through the customs administrations of participating foreign countries).

DHL and the international express delivery industry are concerned not only with the scope of the special advantages afforded to the USPS but with the aggressive efforts of the USPS to use these advantages to expand into new competitive markets and services. The USPS has made it clear that it intends to capitalize fully on its special "mail" privileges in competing for international delivery business. In its recent marketing plans, the USPS notes that "[t]he international mailing market is deregulated and intensely competitive, particularly in the expedited and package markets." The USPS will compete in this open and competitive market by availing itself of special advantages that flow from its status as the national postal monopoly, noting that its "close contacts with foreign postal administrations and governments provide a unique customer value" and a "competitive advantage" that can be "leveraged" in seeking new international business.<sup>7</sup>

The development of the GPL service and other new USPS international services vividly illustrates the unchecked growth of unfair USPS competition in the international delivery market. From its beginnings in late 1994 as a special program for catalogue company deliveries to Japan, the GPL service has been expanded to 10 additional markets—Brazil, Canada, Chile, China, France, Germany, Hong Kong, Mexico, Singapore and the United Kingdom—and its minimum requirements have been considerably liberalized. These extensive forays into the competitive inter-

<sup>7</sup> USPS 1998 Marketing Plans at INT p. 2 (Oct. 1997).

national market have often occurred under “interim rules” with no meaningful oversight or prior public participation. In recent months, for example, the USPS published an “interim rule,” to take effect immediately, under which mail order companies can send catalogues to the foregoing countries for as low as \$0.80 per piece, provided that they use the GPL service to deliver resulting orders.<sup>8</sup> This program is but a further effort by the USPS to leverage its unfair cost and regulatory advantages—through a classic tying arrangement—to gain further inroads in the competitive international market.

It is inequitable to permit the USPS to benefit from cost and regulatory privileges that are available only to national postal administrations when it is seeking to provide—with no meaningful oversight—international delivery services that are directly competitive with the private sector. These special advantages harm not only the international express industry but also lead to economic inefficiencies that affect every American. Each time the USPS uses its monopoly or quasi-governmental status or special legal privileges to obtain an unfair advantage over its competitors, its services are not as efficient as those provided by a company that would provide the services on a competitive basis. Whether through higher costs for consumers of non-competitive products like standard mail, or through the inefficient use of capital and labor that could be used more efficiently in other economic sectors, these practices inevitably damage and distort the United States economy.

#### *IV. Specific Comments on International Postal Service Reform Legislation*

DHL believes that legislation to reform international postal and delivery services should address each of the problem areas outlined above. Accordingly, as described below, DHL urges the Senate to amend S. 2082 to include other necessary reforms to parallel the draft legislation now being considered in the House.

##### *A. PRC Jurisdiction Should be Extended to International Postal Services.*

S. 2082 should subject international postal services to review by the PRC. As noted above, the public policy considerations that underlie PRC review of domestic mail rates—controlling predatory pricing and abuses of monopoly power—apply with equal force to the classification and pricing of international mail. S. 2082 addresses the significant gap in current law by extending PRC authority to include review of international services and rates. DHL strongly supports this important change in law.

##### *B. S. 2082 should be Amended to Eliminate USPS’ Inherent Conflicts of Interest in its Dual Roles as Regulator and Competitor and to Ensure Equal Application of the Laws.*

The private delivery industry believes that rapid technological change and the continued evolution of the global market for information transfer call for a serious examination by Congress of whether the Private Express Statutes are obsolete and the postal monopoly should finally be ended. Although Congress may not yet be ready to take such steps, it can, by restricting the most serious abuses under current law, make meaningful and pro-competitive reforms in the rules governing international postal and delivery services. DHL urges the Senate to add the following additional provisions governing international postal and delivery services to S. 2082:

- 1. USPS’ Regulatory and Operational Roles Must be Legally Separated.

As explained above, the USPS’s authority under 39 U.S.C. § 407 to represent the United States at intergovernmental organizations and its exclusive access to national postal authorities enables USPS to unfairly advance its competitive position in the international market place at the expense of its private competitors. The USPS cannot adequately represent the concerns of the entire U.S. international delivery sector because, as a competitor, it has an interest to seek measures that are most beneficial to itself. It is imperative that U.S. law be amended to eliminate this inherent conflict of interest.

##### *a. The Postal Laws Should Contain a Clear Statement of U.S. Policy on the Separation of Regulatory and Operational Functions.*

U.S. law should include an express statement that it is the policy of the United States to promote and encourage a clear distinction—in the U. S. Government and in the intergovernmental organizations of which the United States is a member—between regulatory and operational responsibilities with respect to the provision of international postal services and other international delivery services. Such a statement is consistent with traditional American notions of due process and equal pro-

<sup>8</sup>52 Fed. Reg. 13124 (Mar. 18, 1998).

tection of the laws and comports with the European Union's competition rules for public and private postal services in Europe. This policy statement would also give clear direction to U.S. negotiators in seeking to eliminate foreign laws and practices maintained by national postal administrations and their governments that discriminate against private international delivery companies. Such a statement would send a powerful signal to foreign governments, U.S. government agencies, the USPS and the private sector that the United States supports the development of international postal policies and practices based on fair competition and non-discrimination against private delivery firms.

*b. Responsibility for U.S. Postal Policy Formulation and Intergovernmental Negotiation Authority Should be Transferred to an Appropriate Federal Agency.*

Authority to formulate U.S. policy on international postal and delivery service matters and to represent the United States in intergovernmental postal negotiations should be transferred from the USPS to an appropriate agency of the Federal government. DHL has previously proposed that the United States Trade Representative ("USTR") exercise these responsibilities and continues to believe that USTR is best suited to serve in this capacity. DHL understands, however, that there may be technical or other policy reasons that might, instead, favor the Department of State for this important role. Should Congress decide that State, rather than USTR, should represent the United States in international organizations, State should, in any event, be required to consult with and fully consider the views of other appropriate agencies, including USTR, the Departments of Commerce, Justice and Transportation, as well as the PRC.<sup>9</sup> Moreover, the law should provide that, in exercising these functions, the appropriate agency should consult with the USPS and the private sector on the same basis—the USPS should have no special status with respect to consultations with the Federal government on the regulation of international services.

These provisions will help assure that the rules governing international postal and delivery services will be developed and applied in an impartial manner and that the interests of the entire U.S. delivery sector are represented before intergovernmental organizations. Unlike the USPS, the USTR (or State) would have no inherent conflict of interest. Moreover, the U.S. government has a proven track record in seeking open, pro-competitive and transparent rules for international trade in goods and services, including delivery services. Such substantial efforts will be required to eliminate the rules and practices of foreign postal administrations and their governments that discriminate against private international delivery firms. Granting policy formulation and negotiating authority to the USTR (or State) would enable the United States to advance these important policy goals and to ensure fairness for all international delivery providers.

*c. The Law Should Forbid Discrimination in Agreements and Contracts.*

The USPS should continue to be empowered to enter into contracts and agreements for international postal and delivery services as it deems appropriate. However, such contracts and agreements should not be considered obligations of the United States and the USPS should be required to notify the PRC and USTR (or State) of agreements with foreign governmental agencies or instrumentalities.

U.S. law should also expressly prohibit any treaty, convention or agreement concluded by the United States from making any undue or unreasonable discrimination between the USPS and any other provider of postal or delivery services, except where the provision of such services by private companies is prohibited by U.S. law. Similarly, U.S. law should forbid such discrimination in contracts and agreements between the USPS and foreign government agencies or instrumentalities. These provisions should help to prevent the USPS from abusing its quasi-governmental status to obtain unfair advantages over its private sector competitors.

*d. Postal and Delivery Services Should be Integrated into U. S. Trade Policy.*

International postal and delivery services should be added to the list of services that are monitored by the Department of Commerce (19 U.S.C. 2114b) and are subject to overall trade policy coordination through the USTR (19 U.S.C. 2114c).

In negotiating international agreements like the North American Free Trade Agreement and General Agreement on Trade in Services, the United States has worked to establish the fundamental international principle that monopolies and state enterprises should not be permitted to employ their monopoly position to en-

<sup>9</sup>In implementing these requirements, State might also consider delegating substantial authority in these matters to USTR.

gage in anticompetitive practices in competitive markets.<sup>10</sup> The U.S. government also has worked with the U.S. international delivery industry on efforts to remove unfair trade barriers in such jurisdictions as the European Union, Mexico and Taiwan.<sup>11</sup> Adding international postal and delivery services to the foregoing list of services would help to assure greater consistency between U.S. postal policy and the Nation's overall international trade policies and goals. Moreover, such a change in the law would also encourage U.S. government efforts to identify and eliminate foreign practices that discriminate against private international delivery firms.

*2. The Law Should Ensure Equal Application of Fair Trade Rules to USPS Competitive Services.*

As illustrated by its Global Package Link Service and other competitive international services, the USPS is moving aggressively to compete directly with fully integrated international delivery providers like DHL. In providing these new services in the competitive sector, the USPS should no longer be permitted to exploit its quasi-government status to gain unfair competitive advantages.

*a. The Postal Laws Should Contain a Clear Statement of U.S. Policy Regarding Equal Application of Relevant Laws.*

U.S. law should include an express statement that it is the policy of the United States to promote and encourage unrestricted and undistorted competition in the provision of international postal and delivery services. Such a clear statement of policy would help to assure the equal application of U.S. laws to competitive international delivery services and would provide guidance, direction and negotiating leverage to U.S. government efforts to eliminate foreign laws and practices that unfairly discriminate against private delivery services.

*b. The Postal Laws Should Define Competitive Services*

A definition of "competitive international postal services" should be added to U.S. law. Such services should be defined as those international postal services that are provided by or on behalf of the USPS and that compete directly with services provided by private companies. The PRC should be authorized by law to designate specific international postal services that meet this definition.

*c. Antitrust and Unfair Competition Laws Should be Applied Equally.*

In providing competitive international postal services, the law should make clear that USPS is subject to the antitrust provisions of the Clayton and Sherman Acts and the Federal Trade Commission Act in the same manner as a private company that provides such services. The USPS should not be permitted to engage in anti-competitive acts while in direct international competition with private delivery firms.

*d. Customs and Tax Laws Should be Applied Equally.*

Postal reform legislation should also require equal application of laws governing imports and exports and taxes to competitive international services provided by the USPS and its private competitors. Specifically, U.S. law should require that, with respect to the USPS' competitive international postal services—

- USPS may not tender export shipments to foreign government authorities for clearance and importation except under laws and procedures that are equally applicable to similar shipments by private firms;
- U.S. customs laws shall be applied to USPS importations and exportations in the same manner as they are applied to similar shipments by private companies; and
- Simplified customs procedures under international postal or customs agreements shall not be available to USPS imports from foreign countries that have such procedures but deny access to such procedures to shipments from the United States by the USPS or private companies.

The law should also contain provisions designed to prevent foreign postal administrations from imposing discriminatory taxes that are designated to protect their national postal monopoly from competition from U.S. private delivery firms.

<sup>10</sup>See North American Free Trade Agreement, Chapt. 15; General Agreement on Trade in Services, Art. VIII. For example, NAFTA Article 1502 requires each participating country to assure, "through regulatory control, administrative supervision or the application of other measures" that private and government monopolies do not use their monopoly position to "engage . . . in anti-competitive practices in a non-monopolized market in its territory that adversely affect [a private foreign party], including through the discriminatory provision of the monopoly good or service, cross-subsidization or predatory conduct." *Id.*

<sup>11</sup>See 1997 National Trade Estimate on Foreign Trade Barriers.

*e. Congress Should Require a Study of Unequal Application of Other Laws*

In addition to mandating immediate changes in the application of the foregoing laws, DHL believes that international postal reform legislation should also provide for a study by Department of Justice of other legal disparities in the treatment of competitive international services provided by the USPS and private firms. A detailed, objective study of all differences in treatment is crucial to assuring that the goal of equal treatment for competitive international services is, in fact, fully implemented. Congress should move rapidly to fully implement any recommended changes as soon as possible after the issuance of the Department's report.

*V. Conclusion*

In areas such as trade and telecommunications, the United States has been a world leader in efforts to free international markets from outdated regulatory schemes which hamper free and fair competition. Some foreign countries are beginning to liberalize their own postal regimes by moving toward privatization. Liberalization is long overdue in our own Nation's postal laws as well. DHL believes that enactment of S. 2082, together with the additional provisions described above, is an important first step in this process. DHL is pleased to support S. 2082 and looks forward to working with the Chairman and Members of this Subcommittee on this important legislation.

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PREPARED STATEMENT OF DIRECT MARKETING ASSOCIATION

Chairman Cochran and Members of the Subcommittee on International Security, Proliferation and Federal Services:

Thank you for this opportunity to testify on S. 2082, a bill that would place the setting of international postal rates under the authority of the Postal Rate Commission in the same manner that domestic postal rates are established.

Established in 1917, The Direct Marketing Association is the oldest and largest trade association for business and nonprofit organizations using direct marketing to reach their customers, members, and prospects. We represent more than 3,600 companies in the United States and 47 other nations. These include members such as L.L. Bean, which will have an official testifying at this hearing, that are becoming increasingly involved in the global marketplace.

In addition, this statement is being made on behalf of the Coalition in Support of International Trade and Cooperation, a group of postal customers, trade associations representing those customers, and postal employee organizations and unions, all of which will be significantly affected by this legislation. The members of the coalition include:

Advertising Mail Marketing Association, Washington, D.C.  
 American Postal Workers Union, Washington, D.C.  
 Ballard Designs, Atlanta, GA  
 L.L. Bean, Freeport, ME  
 Current, Inc., Colorado Springs, CO  
 Damark International, Inc., Minneapolis, MN  
 The Direct Marketing Association, Washington, DC  
 Fingerhut Companies, Inc., Minnetonka, MN  
 Frontgate, Lebanon, OH  
 Garnet Hill, Lebanon, NH  
 Hammacher Schlemmer, Chicago, IL  
 J.C. Penney Company, Plano, TX  
 Land's End, Dodgeville, WI  
 Mail Order Association of America, Washington, D.C.  
 National Association of Letter Carriers, Washington, D.C.  
 National Association of Postal Supervisors, Alexandria, VA  
 National Association of Postmasters of the United States Alexandria, VA  
 National League of Postmasters, Alexandria, VA  
 National Retail Federation, Washington, DC  
 National Rural Letter Carriers Association, Arlington, VA  
 Parcel Shippers Association, Washington, DC  
 Performance Data TransUnion Corporation, Chicago, IL  
 Territory Ahead, Santa Barbara, CA  
 TravelSmith, Novato, CA  
 Whispering Pines, Fairfield, CT

We respectfully oppose S. 2082 in its current form.

S. 2082 would place international postal rates under the ratemaking process outlined in Title 39 of the U.S. Code. That process was the creature of the Postal Reor-

ganization Act of 1970, which removed postal rate making from the legislative process to a regulatory process superficially similar to public utility ratemaking.

In that process, the Postal Service Board of Governors is solely responsible for developing and proposing increases in the rates of postage. When it decides rate adjustments are necessary, the board files an extensive request with the Postal Rate Commission, which then commences an extensive proceeding on the record in accordance with the Administrative Procedure Act.

The Postal Rate Commission must complete its consideration of the proposal within ten months. If it has not issued a recommended decision within that time frame, the Governors may put their proposed rates into effect on a temporary basis. However, this has not happened in a major rate case since the ten month period was enacted in the late 1970's.

When it concludes its proceeding, the Commission then forwards its recommended decision to the Governors, who have sole authority to implement the new rates. If the Governors disagree with the Commission's recommendations, they have a series of options including refusing to implement the rates or sending the recommended rates back to the Commission for reconsideration. After the commission sends the reconsidered case back to the Governors, the Governors may then change the proposed rates by a unanimous vote. This has happened once in a major rate case, in 1980.

We feel that this process is much too cumbersome, time consuming, and expensive for domestic rates and see nothing but harm to customers of both the Postal Service and its competitors in applying this process to international rates

We are opposed to S. 2082 for four basic reasons:

1. It would place the Postal Service in a severely negative competitive position by removing the flexibility to set international rates when necessary to meet competitive pressures and provide the best service for its customers. The complexity and length of the ratemaking process mandated by this bill would probably mean that the Postal Service could not compete against its largely unregulated competitors.

The bill is being pushed by competitors of the Postal Service as "leveling the playing field." Just the opposite would occur. No competitor of the Postal Service in the international mail field is required to submit to a lengthy rate proceeding. They are essentially free to set prices as they wish, when they wish.

The requirement for a lengthy rate proceeding would be anti-competitive for another reason. Competitors would get an advance glimpse at new products, which would give them ample opportunity to develop counter measures to meet and beat the new competition. Businesses in other fields, say the automobile industry, would dearly love to have this competitive advantage over their rivals.

In the final analysis, the principal losers in this battle of the behemoths—the Postal Service and its competitors—will be American businesses that are working to build their international business.

2. The Postal Rate Commission already has on file data that, in our opinion, show that the Postal Service is not using money from other classes of mail to subsidize international postal rates. Overall, international postal rates cover all of their attributable costs and contribute more than \$300 million annually to overhead costs.

The concern about cross-subsidization is a legitimate one, and one that was addressed directly in the Postal Reorganization Act of 1970, which forbids cross-subsidization. A simple reporting requirement, however, would be sufficient and far less destructive to the international business of the Postal Service and its customers.

3. The process of setting international postal rates is ultimately based on treaties and agreements among nations in accordance with policies developed by the Universal Postal Union, all of which are and should be outside the purview and cost-based regulatory expertise of the Postal Rate Commission.

In fact, the extensive hearings before the Commission required by S. 2082 would require the Postal Service to provide specific country-by-country data which could undermine America's position in any treaty negotiations on international postal rates with other countries. This bill would further unlevel the playing field against the Postal Service in favor of foreign nations whose postal authorities, such as Royal Mail and Dutch Post, are already operating in the United States and competing with the Postal Service and American businesses for international mail business. This bill creates a tilted playing field that favors foreign countries over the American government, American businesses and American workers.

4. The failure to include international postal rates in the ratemaking process created by the Postal Reorganization Act was not an "oversight." Prior to the Postal Reorganization Act, Congress, through the regular legislative process, set all domestic postal rates, but never set international rates. Those rates were always set by the Postal Service by the process mentioned above. Congress saw no need to change that process.

Much has been made by postal competitors about “leveling the playing field” in the competition for international mail and parcels. The charges are that the Postal Service enjoys advantages that private companies do not have that tilt the playing field toward the Postal Service. They claim that this is particularly true in the international area.

The truth, we believe, is far more complex than that. Both the Postal Service and private competitors enjoy unique advantages and suffer from unique disadvantages that affect their ability to compete and affect the service that we customers receive. We agree that a full study should be made to determine what needs to be done, if anything, to assure that the playing field is indeed level in the international area.

One thing is certain now, however, is that S. 2082 would dangerously tilt the playing field against the Postal Service in its efforts to compete effectively in the volatile international mail market. Customers, American businesses, can only lose.

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LETTER FROM R.R. DONNELLEY AND SONS COMPANY FOR THE RECORD

R.R. DONNELLEY AND SONS COMPANY

June 2, 1998

Hon. Thad Cochran, *Chairman*  
*Subcommittee on International Security, Proliferation and Federal Services*  
*Committee on Governmental Affairs*  
*U.S. Senate*  
*Washington, DC*

DEAR MR. CHAIRMAN: I am pleased to offer the views of R.R. Donnelley and Sons Company for the record of the Subcommittee's June 2, 1998 hearing on S. 2082, the International Postal Service Act of 1998. As both the leader of the U.S. printing industry and the largest customer of the U.S. Postal Service (USPS), our company has a significant stake in assuring the continued global competitiveness of both the postal system and mailed print. We greatly appreciate your leadership on the entire array of postal issues and urge the Subcommittee to carefully consider the implications of this legislation, which has the potential for unintended, yet adverse, consequences.

*Introduction*

As you know, R.R. Donnelley and Sons Company is a \$5+ billion, Fortune 250 leader in the management, reproduction, and distribution of print and digital information for the publishing, retailing, merchandising and information technology industries. We employ over 25,000 people throughout the world, with plants and facilities in 31 States, including such States as Mississippi, Pennsylvania and Illinois.

Simply put, it is reasonably-priced, universal service on both an international and domestic basis that drives our business interest in postal policy issues such as S. 2082. We share and support our customers' need for a global distribution channel that provides universal service to residential and commercial customers every day in a predictable and consistent manner. To this end, we engage the services of the U.S. Postal Service—as well as those of United Parcel Service, Federal Express and a variety of other alternative service providers—in serving the global business needs of our customers. We foresee no change to this requirement and, therefore, are concerned about any potential changes to current law that would hamper the ability of our customers to access any of the existing international mail options currently available to them.

That having been said, we also state our appreciation and endorsement of the basic principle underlying S. 2082. It does not serve either our customers' interests or our own to have the Postal Service subsidize its international postal services through revenues derived from its domestic services. At the same time, we believe with equal conviction that neither the American economy nor the American public is well served by subjecting the U.S. Postal Service to an additional layer of regulation in the international arena unless and until all alternatives have been very thoroughly explored and found inadequate to the task.

*Key Policy Issues*

As we stated in our comments to House Postal Subcommittee Chairman John McHugh on the proposed revisions to H.R. 22, we believe there is an important need to update the existing statutory framework which governs the operations of the USPS. The current statutory blueprint was enacted nearly three decades ago: Prior to the first global oil embargo, prior to the reengineering that has so dramatically changed the operations of so many companies in both the manufacturing and service

sectors of our economy, and prior to the arrival of the fierce competition arising out of globalization and international competition.

For the overall American economy, Congress has responded to these dramatic changes through a variety of policy initiatives that have increased business flexibility, deregulated industrial operations, and enhanced U.S. trade and exports. These solutions have paid handsome dividends to the U.S. economy and are, in large measure, responsible for the prosperity we are experiencing today. They are also, in our view, appropriate measures to guide development of postal policy in the 21st century. As a result, we are concerned that any legislative proposal which adds new or additional regulatory burdens—in either the postal or any other industrial sector—may run contrary to the flexibility/deregulation/export-growth recipe which has served our Nation's economy so well over the past 20 years.

Therefore, R.R. Donnelley and Sons Company urges the Subcommittee to fully review and explore the following questions:

- *Is current governance in this issue area insufficient/inadequate?* The Governors of the Postal Service are already required to establish “reasonable and equitable” classes of mail and “reasonable and equitable rates of postage” for both international and domestic postal services. Although international rates are not subject to review by the Postal Rate Commission, we are aware of no evidence which suggests that the Governors—all of whom have been appointed by the President with the advice and consent of the United States Senate—have been unsuccessful in the discharge of their responsibilities with respect to international mail service.
- *Is the PRC the appropriate regulatory forum?* Assuming that third party review of international rates is truly necessary, it is appropriate to examine whether the Postal Rate Commission is the proper forum for such review. International postal services involve multi-layered and often complex treaty and contractual arrangements with foreign postal administrations. It is clear that while the Commission continues to do an admirable job with domestic mail regulation, it has no experience or expertise in the international area. Moreover, as the world's largest postal system and the world's largest exporter of mail, the U.S. Postal Service must have the flexibility to serve all American businesses and individuals who have need for international mailing services in its dealings with the International Postal Union and in its bilateral negotiations of terminal dues and other settlement arrangements with countries throughout the world.
- *What are the consequences of subjecting all international postal services to the jurisdiction of the Postal Rate Commission?* Other than the United States Postal Service, there really are only a very few alternative international service providers and fewer still that are willing to provide universal service worldwide. If rate regulation of international services deprives the U.S. Postal Service of revenues on high volume routes (that its private sector competitors are interested in serving), the Postal Service may well be forced to increase rates to destinations where the Postal Service is the only service provider. This approach to rate determination also has potential implications on the issue of universal service to the more remote and less populated parts of the domestic system.

#### *Conclusion*

We believe that the underlying purpose of S. 2082 has legitimate merit but that a variety of economic and policy trends strongly counsel Congress stopping short of formally imposing rate regulation on the U.S. Postal Service's international services. Moreover, we see a number of alternatives to rate regulation that are available and worthy of Subcommittee consideration before further action is taken on the current proposal.

We thank you for the opportunity to submit our views to you and stand ready to work with you on the important task of finding a solution to the questions and concerns that underlie S. 2082 in a way that serves the interests of all Americans.

Sincerely,

JONATHAN P. WARD,  
*President and Chief Operating Officer*

## LETTER FROM MR. HENDERSON WITH RESPONSES TO QUESTIONS

UNITED STATES POSTAL SERVICE

August 14, 1998

Hon. Thad Cochran, *Chairman*  
*Subcommittee on International Security, Proliferation and Federal Services*  
*Committee on Governmental Affairs*  
*U.S. Senate*  
*Washington, DC*

DEAR MR. CHAIRMAN: Thank you for the opportunity to testify at your Subcommittee's June 2 hearing on S. 2082, the International Postal Services Act of 1998.

I am encouraged that your efforts to review the existing arrangements affecting the exchange of mail with other nations take into account the experience and perspective of the Postal Service. While international delivery offers opportunities for various carriers to serve specific segments of the market, only the United States Postal Service provides every American mailer with a full-service gateway to every corner of the world.

Enclosed are responses to questions that were raised at the hearing or subsequently submitted for the hearing record. If I can be of additional assistance on this, or any other postal issue, please let me know.

Sincerely,

WILLIAM J. HENDERSON

## QUESTIONS FOR RECORD OF INTERNATIONAL POSTAL SERVICES ACT HEARING

1. How often does the Postal Service change international rates?
  - A. The Postal Service changes the majority of its international postage rates (air letters and cards, surface printed matter, publishers' periodicals, surface parcel post, air printed-matter and air parcel-post), on a cycle that generally conforms to the implementation of domestic rates. Rate modifications for other categories of international mail are done on an as-needed basis. These categories can include International Surface Air Life (ISAL), International Priority Airmail (IPA), Global Package Link (GPL), Express Mail International Service (EMIS), and Global Priority Mail (GPM).
2. Is the Postal Service developing new rates for international mail at this time? And if you are, when do you anticipate that new international rates will be announced?
  - A. Yes, new postage rates for international mail are now being developed. They will be publicly announced for notice and comment following their approval by the Postal Service's Board of Governors, which will be requested in September.
3. What is the time frame for the completion of the Inspector General's report on international postal rates?
  - A. The Inspector General anticipates issuing a report by the end of the calendar year. Since the June 2 hearing, the Office of the Inspector General has solicited input from professional Congressional staff members, the Postal Rate Commission, Postal Service officials, and the General Accounting Office. In initiating the audit regarding the process of how international cost and revenue data are developed, the Office of the Inspector General is focusing its efforts mainly on the accumulation and validation of data.
4. Has the Postal Service conducted any studies to estimate the costs of meeting its obligations as a member of the UPU? And if so, could you provide us the results of those studies?
  - A. No such studies exist, but we are working to develop estimates that we will be happy to share with you.
5. Has the Postal Service conducted any studies to estimate the cost of providing universal mail service on an international basis? If so, could you provide us the results of that study?
  - A. No specific studies have been conducted to estimate the cost of the United States Postal Service's universal service obligation. However, we are working to develop estimates that we will share with you.

