THE POSTAL SERVICE IN CRISIS: A JOINT SENATE-HOUSE HEARING ON PRINCIPLES FOR MEANINGFUL REFORM

JOINT HEARING

BEFORE THE

COMMITTEE ON GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

AND THE

COMMITTEE ON GOVERNMENTAL AFFAIRS

UNITED STATES SENATE

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THE POSTAL SERVICE IN CRISIS: A JOINT SENATE-HOUSE HEARING ON PRINCIPLES FOR MEANINGFUL REFORM

TUESDAY, MARCH 23, 2004

HOUSE OF REPRESENTATIVES, COMMITTEE ON GOVERNMENT REFORM, JOINT WITH THE COMMITTEE ON GOVERNMENTAL AFFAIRS, U.S. SENATE,

Washington, DC.

The committees met, pursuant to notice, at 2:40 p.m., in room 2154, Rayburn House Office Building, Hon. Tom Davis (chairman of the Committee on Government Reform) presiding.

Present: Representatives Tom Davis of Virginia, Burton, McHugh, Schrock, Duncan, Miller, Murphy, Turner, Carter, Blackburn, Tiberi, Towns, Maloney, Cummings, Davis of Illinois, Clay, Van Hollen, Ruppersberger and Norton.

Also present: Senators Collins and Carper.

Staff present for the Committee on Government Reform: Melissa Wojciak, staff director; Keith Ausbrook, chief counsel; Ellen Brown, legislative director and senior policy counsel; Jack Callender, counsel; Robert Borden, counsel/parliamentarian; Drew Crockett, deputy director of communications; Teresa Austin, chief clerk; Brien Beattie, deputy clerk; Corinne Zaccagnini, chief information officer; Althea Gregory, minority counsel; Denise Wilson, minority professional staff member; Earley Green, minority chief clerk; and Jean Gosa, minority assistant clerk.

Chairman TOM DAVIS. The committee will come to order. I want to begin by welcoming the Members of the Senate Governmental Affairs Committee to our hearing room, and especially thank Chairman Collins and Senator Carper for their tireless work on this important issue.

This joint hearing caps off a series of six hearings conducted by the Senate Governmental Affairs Committee and three hearings conducted by this committee's Special Panel on Postal Reform and Oversight since the report of the President's Commission on the U.S. Postal Service was released last July. I think that one thing we have learned from all of these hearings and from the work of the President's Commission is that the current legal framework under which the post office operates is outdated and unsuited for today's economy. It's putting the jobs of millions of Americans at risk.

Let me explain. Under current law, the only response available to the Postal Service that they have to declining volumes and revenues is to raise rates even further. As rates go up, even more vol-

ume leaves the system, contributing to what Comptroller General David Walker has called a death spiral. First class mail volumes have been in decline for several years, even as the number of addresses that the Postal Service serve increases.

I believe that without comprehensive postal reform this year, we face a time in the near future when the Postal Service will no longer be able to sustain itself with higher and higher rate increases. And many of the 9 million Americans whose jobs rely on a stable, healthy postal system will be out of work.

The postal reform is not only a job issue, it's a consumer issue. Everyone gets mail, and everyone buys stamps. If we allow the Postal Service to continue its death spiral, it will hit every American in the pocketbook.

Last year this committee and the Senate Governmental Affairs Committee worked together along with the administration to solve a potential overfunding of the Civil Service Retirement System by postal taxpayers—ratepayers. That reform delayed the next rate increase until 2006, providing much needed relief for the Postal Services customers, but it left several unresolved issues which we must deal with as the legislation moves forward.

First, the legislation transferred responsibility for funding the military portion of retiree benefits to the Postal Service for CSRS. I realize there are differences of opinion on whether that change should be revisited or left in place, and I look forward to the witnesses' perspectives on that.

Second, the legislation required the Postal Service to calculate, collect and place into escrow the post-2005 savings caused by the legislation. We wanted to get a clear sense of the Postal Service's plans for cost reduction and productivity-enhancing capital improvements before releasing all the savings. I believe that the Postal Service has fulfilled its requirements in this regard, and I think it's now time to release the escrow.

Let me take a moment to explain the budget effects in the CSRS escrow because there seems to be a great deal of confusion about it. When we took up the administration's proposed Postal CSRS Reform Act last year, the bill, as it was written by the administration and introduced with budget-neutral changes in the Senate as S. 380, it had a CBO-estimated cost of $17 billion between 2003 and 2008 and $42 billion between 2003 and 2013. In the House, H.R. 1169 as introduced placed the savings to ratepayers, which counts as a cost in the unified budget, in escrow by requiring the Postal Service to collect the savings from its customers beginning in 2006 and not spend it without prior congressional approval. This bill and the bill which eventually was enacted had a CBO-estimated cost of only $7.2 billion between 2003 and 2013. Compare that to the 42 billion cost without the escrow. All we did was put off, temporarily, the majority of the budget hit from the Postal CSRS Reform Act as proposed by the administration.

This year the chickens are coming home to roost. Sometime in the late fall, shortly after the beginning of fiscal year 2005, the Postal Service will be filing a rate increase to take effect at the beginning of fiscal year 2006. If we have not released the escrow, that rate increase will likely include an extra 2-cent surcharge on the

rate of a first class stamp as part of an extra 5.4 percent rate increase across the board solely to fund the escrow amount.

Releasing the escrow will be a crucial component of comprehensive postal reform legislation, but the administration, according to Secretary Snow's testimony today, says they are, "willing to work toward a proposed modification of the Postal CSRS Funding Reform Act abolishing that escrow that will not increase the deficit." Therefore, we expect the administration to find the necessary offsets to accomplish this goal so that the comprehensive postal reform legislation can move forward, and we won't be faced with the largest rate increase, really tax increase, in postal history.

If we are going to prevent a postal melt-down from happening, this is the year. For the first time since the Nixon administration, the White House has called for comprehensive postal reform. We are very fortunate to have Treasury Secretary Snow here today to present the administration's case for postal reform. We also have the guidance of the President's Commission on the Postal Service, which did an extraordinary job in a very short amount of time. We can also build on the 9 years of hard work that Chairman McHugh and Chairman Burton devoted to this issue.

And last but not least, our colleagues in the Senate who join us today are as committed as we are to preventing the Postal Service from melting down.

I look forward to working with everyone in this room as we move toward comprehensive postal reform legislation. I want to thank all of our witnesses for appearing before the committee, and I look forward to their testimony.

[The prepared statement of Chairman Tom Davis follows:]

OPENING STATEMENT
CHAIRMAN TOM DAVIS
HOUSE GOVERNMENT REFORM COMMITTEE
AND SENATE GOVERNMENTAL AFFAIRS COMMITTEE
"THE POSTAL SERVICE IN CRISIS: A JOINT SENATE-HOUSE HEARING ON PRINCIPLES FOR MEANINGFUL REFORM"

23 MARCH 2004

I would like to begin by welcoming the members of the Senate Governmental Affairs Committee to our hearing room, and thanking especially Chairman Collins and Senator Carper for their tireless work on this important issue. This joint hearing caps off a series of six hearings conducted by the Senate Governmental Affairs Committee and three hearings conducted by this Committee's Special Panel on Postal Reform and Oversight since the report of the President's Commission on the United States Postal Service was released last July.

I think that one thing we have learned from all these hearings, and from the work of the President's Commission, is that the current legal framework under which the Postal Service operates is outdated and unsuited for today's economy. It is putting the jobs of millions of Americans at risk.

Let me explain: under current law, the only response available to the Postal Service to declining volumes and revenues is to raise rates even further. As rates go up, even more volume leaves the system, contributing to what Comptroller General David Walker has called a "death spiral." First Class Mail volumes have been in decline for several years, even as the number of addresses the Postal Service serves increases.

I believe that without comprehensive postal reform this year, we face a time in the near future when the Postal Service will no longer be able to sustain itself with higher and higher rate increases. And many of the nine million Americans whose jobs rely on a stable, healthy postal system will be out of work.

But postal reform is not only a jobs issue, it is a consumer issue. Everyone gets mail, and everyone buys stamps. If we allow the Postal Service to continue its death spiral, it will hit every American in the pocketbook.

Last year, this Committee and the Senate Governmental Affairs Committee worked together, along with the Administration, to solve a potential overfunding of the Civil Service Retirement System by postal ratepayers. That reform delayed the next rate increase until 2006, providing much-needed relief for the Postal Service's customers. But it left several unresolved issues, which we must deal with as the legislation moves forward.

First, the legislation transferred responsibility for funding the military portion of retiree benefits to the Postal Service. I realize there are differences of opinion on whether that

change should be revisited, or left in place, and I look forward to the witnesses' perspectives on that.

Second, the legislation required the Postal Service to calculate, collect, and place into escrow the post-2005 savings caused by legislation. We wanted to get a clear sense of the Postal Service's plans for cost reduction and productivity-enhancing capital improvements before releasing all of the savings. I believe the Postal Service has fulfilled its requirements in this regard, and it's time to release the escrow.

Let me take a moment to explain the budget effects of the CSRS escrow, because there seems to be a great deal of confusion about it. When we took up the Administration's proposed Postal CSRS Reform Act last year, the bill as it was written by the Administration (and introduced with budget-neutral changes in the Senate as S. 380) had a CBO-estimated cost of $17 billion between 2003 and 2008 and $42 billion between 2003 and 2013.

In the House, H.R. 1169 as introduced, placed the savings to ratepayers (which counts as a "cost" to the unified budget) in escrow, by requiring the Postal Service to collect the savings from its customers beginning in 2006 and not spend it without prior Congressional approval. This bill, and the bill which eventually was enacted, had a CBO-estimated cost of only $7.2 billion between 2003 and 2013. Compare that to the $42 billion cost without the escrow. All we did was put off, temporarily, the majority of the budget hit from the Postal CSRS Reform Act as proposed by the Administration.

This year, the chickens are coming home to roost. Sometime in the late fall, shortly after the beginning of Fiscal Year 2005, the Postal Service will be filing a rate increase to take effect at the beginning of Fiscal Year 2006. If we have not released the escrow, that rate increase will likely include an extra 2 cent surcharge on the price of a First Class stamp, as part of an extra 5.4 percent rate increase across the board – solely to fund the escrow account. Releasing the escrow will be a crucial component of comprehensive postal reform legislation.

But the Administration, according to Secretary Snow's testimony today, says they are, and I quote, "willing to work toward a proposed modification of the Postal CSRS Funding Reform Act abolishing the escrow ***that will not increase the deficit***." Therefore, we expect the Administration to find the necessary offsets to accomplish this goal so that comprehensive postal reform legislation can move forward.

If we're going to prevent a postal meltdown from happening, this is the year. For the first time since the Nixon Administration, the White House has called for comprehensive postal reform. We are very fortunate to have Treasury Secretary Snow here today to present the Administration's case for postal reform. We also have the guidance of the President's Commission on the Postal Service, which did an extraordinary job in a very short amount of time. We can also build on the nine years of hard work Chairman McHugh has devoted to this issue. Last but not least, our colleagues in the Senate who join us today are as committed as we are to preventing the Postal Service from melting

down. I look forward to working with everyone in this room as we move comprehensive postal reform legislation forward.

Chairman TOM DAVIS. I now call on my Senate counterpart, Senator Collins, for any opening statement.

Senator COLLINS. Thank you, Mr. Chairman.

I am very pleased to join Chairman Davis and my House colleagues in conducting a joint hearing on postal reform. For the Senate Committee on Governmental Affairs, this represents the seventh in a series of hearings that began last September. Our Senate hearings have focused on the 35 legislative and administrative recommendations of the President's Commission on the Postal Service, recommendations that are designed to help this 225-year-old service remain viable over the long term.

So much depends upon the Postal Service's continued viability. The Postal Service itself has more than 730,000 employees. Less well known is the fact that it is also the linchpin of a $900 billion mailing industry that employs 9 million Americans in fields as diverse as direct mailing, printing, catalog production, paper manufacturing and financial services. The health of the Postal Service is essential to thousands of companies and the millions that they employ.

At our first hearing last September, the committee heard from Commission Cochair Jim Johnson. Commissioner Johnson made the very important point that the Postal Service's short-term fiscal health will not last, and that Congress must not ignore the fundamental reality that the Postal Service as an institution is in serious jeopardy. At the committee's second hearing, we heard from the Postmaster General and Comptroller General David Walker. Mr. Walker, of the General Accounting Office, warned us about the Postal Service's $92 billion in unfunded liabilities and other obligations as set forth in the Commission's report. He pointed to a need for fundamental reforms to minimize the risk of either a significant taxpayer bailout or dramatic postal rate increases such as the chairman has described.

In February, the committee heard from representatives of the four largest postal unions, along with the postmaster and supervisor associations. Earlier this month at our fifth and sixth hearings, we heard from members of the mailing community and from postal competitors. We focused not only on the work force and financial recommendations, but also heard testimony on the Postal Service's monopoly, mission, the rate-setting process and corporate governance issues.

As a Senator representing a largely rural State whose citizens depend heavily on the Postal Service, I appreciate and endorse the Postal Commission's strong endorsement of the basic features of universal service, affordable rates, frequent delivery and convenient community access to retail postal services. It's important to me that the people of my State, whether they are living near our western or northern borders, or on islands, or in our many small rural communities, have the same convenient access to postal services as the people of our cities. We must save and strengthen this vital institution upon which so many Americans rely for communication and for their jobs.

The Postal Service has reached a critical juncture. It's time for action, both by the Postal Service and by the Congress. Senator Tom Carper and I have committed to work together with the other

members of the Senate Governmental Affairs Committee to draft a bipartisan postal reform bill. As this hearing is evidence of, we are also working very closely with House leaders on postal reform, including Chairman Davis and Congressman McHugh. I am very pleased to participate in this historic joint committee hearing today. I think it shows how serious we are about accomplishing this critical task this year.

Thank you, Mr. Chairman.

Chairman TOM DAVIS. Thank you very much.

[The prepared statement of Hon. Susan Collins follows:]

OPENING STATEMENT
SENATOR SUSAN M. COLLINS, CHAIRMAN

The Postal Service in Crisis: A Joint Senate-House Hearing
On the Principles for Meaningful Reform
March 23, 2004

I am pleased to join with Chairman Davis in conducting a joint hearing on postal reform. For the Senate Committee on Governmental Affairs, this is the seventh in a series of hearings that began last September.

Our Senate hearings have focused on the 35 legislative and administrative recommendations of the President's Commission on the U.S. Postal Service—recommendations that are designed to help this 225-year-old Service remain viable over the long term.

So much depends upon the Postal Service's continued viability. The Postal Service itself has more than 730,000 career employees. Less well known is the fact that it is also the linchpin of a $900 billion mailing industry that employs nine million Americans in fields as diverse as direct mailing, printing, catalog production, and paper manufacturing. The health of the Postal Service is essential to thousands of companies and the millions that they employ.

At our first hearing in September, the Committee heard from Commission Co-Chair Jim Johnson. Commissioner Johnson made the very important point that the Postal Service's short-term fiscal health is illusory, and that Congress must not ignore the fundamental reality that the Postal Service as an institution is in serious jeopardy.

At the Committee's second hearing in November, we heard from Postmaster General Jack Potter and Comptroller General David Walker. The Postmaster General described transformation efforts already underway at the Postal Service, many of which are consistent with the Commission's recommendations.

In his testimony, Mr. Walker of the General Accounting Office shared the Commission's concerns about the Postal Service's $92 billion in unfunded liabilities and other obligations. He pointed to the need for "fundamental reforms to minimize the risk of a significant taxpayer bailout or dramatic postal rate increases."

In February, the Committee heard from representatives of the four largest postal unions, along with the postmaster and supervisor associations. The Commission's workforce-related recommendations were discussed at length.

Earlier this month, at our fifth and sixth hearings, we heard from members of the mailing community and postal competitors. We focused not only on the workforce and financial recommendations but also heard testimony on the Postal Service's monopoly and mission, the rate-setting process, and corporate governance issues.

As a Senator representing a largely rural state whose citizens depend on the Postal Service, I appreciate the Presidential Commission's strong endorsement of the basic features of universal service—affordable rates, frequent delivery, and convenient community access to retail postal services. It is important to me that Mainers living near our northern or western borders, or on islands, or in our many rural small towns, have the same access to postal services as the people of our cities.

We must save and strengthen this vital institution upon which so many Americans rely for communication and their livelihoods. The Postal Service has reached a critical juncture. It is time for action, both by the Postal Service and by Congress.

Senator Carper and I have committed to work together with other members of the Senate Committee to draft a bi-partisan postal reform bill. We are also working closely with the House leaders on postal reform, including Chairman Davis and Congressman McHugh.

I am very pleased to have the benefit of hearing today from Treasury Secretary Snow, Postal Service Board of Governors Chairman Fineman, and Postmaster General Potter. I look forward to your testimony.

Chairman TOM DAVIS. Gentleman from Illinois Mr. Davis.

Mr. DAVIS OF ILLINOIS. Thank you very much, Mr. Chairman. I am pleased to join with you in convening the first joint House and Senate hearing on the U.S. Postal Service. I would especially like to applaud the hard work and dedication of Senators Susan Collins, Joseph Lieberman, Ted Stevens, Daniel Akaka and Tom Carper, leaders in the effort to reform and modernize the Postal Service. I am proud to work with you in this effort and prouder still of the momentum we have created, momentum which will surely lead to successful efforts to rewrite the Postal Reorganization Act of 1970.

Today is an important date not just because of the historic nature of a joint hearing on the Postal Service, but because this marks the end of hearings and signals the beginning of Members and staff coming together to draft postal reform legislation. Thankfully we have a very solid foundation upon which to build, H.R. 4970, the Postal Accountability and Enhancement Act.

Since the introduction of H.R. 4970 in the last Congress, much has taken place in the postal world. Beginning in the 108th Congress, we created a new postal panel. The Presidential Commission on the Postal Service was created and issued a report containing 35 recommendations. Those recommendations were followed by the administration's issuance of five principles of comprehensive postal legislation.

Beginning this year our postal panel held a series of hearings addressing various aspects of recommendations submitted by the Presidential Commission and the administration's principles for reform, and as the ranking member of the postal panel, I recently convened the Chicago Advisory Postal Group in which a number of postal-reliant businesses in the Chicago area attended. The message from this group and others was that postal reform must go forward.

I was pleased to note that we agreed on many important issues. Protection of universal service is a universally accepted principle. We need and must protect universal service. The Postal Service must have the flexibility to set rates and provide rate stability. The Postal Service cannot and must not bear the military service payment obligation; and finally, that we need to get rid of the escrow account.

As we continue to work together to craft responsible postal reform legislation, I would like to commend you, Chairman Davis and Mr. McHugh, for taking the time to be engaged and provide direction and input into this valuable process. Your support and that of the mailing community is critical if we are to be successful in passing postal reform legislation. I also want to commend Mr. Waxman, who is the ranking member on our side, for the leadership he has displayed throughout this process. And if we are to be successful in passing this reform legislation, then that spirit of cooperation must, and I am sure will, continue.

With that, I extend a warm welcome to our panelists and look forward to the participation.

Chairman TOM DAVIS. Thank you very much.

Is Mr. McHugh here, chairman of our postal panel?

Mr. MCHUGH. Thank you very much, Mr. Chairman. I note you and Senator Collins and, of course, Mr. Davis covered more than

adequately the full range of issues. So what I would prefer to do, with your forbearance, is to submit my written statement in its entirety for the record and just make a couple of comments.

First of all, I want to add my words of welcome to Senate colleagues, particularly to Senator Collins, who has done such a terrific job as she detailed to some extent in her opening statement with respect to this issue. I admire her courage, her commitment and her dedication to the issue. We don't expect anything less from an esteemed graduate of a great institution of higher learning like St. Lawrence University in Canton, NY, which happens to be in my district, and we are very proud of that fact. But she's been a real leader, as has Senator Carper. And I have had a chance to work with Senator Carper as well for a number of years now, and we are very appreciative of their concern and their efforts.

Chairman Davis mentioned 9 years. It dawned upon me that there are individuals who actually murder people who are sentenced to less time. But it's been an interesting journey, and I want to thank former Chairman Burton for his role in my sentencing and for allowing me to participate. And I make jest of it, but it has been one of the more fascinating stories of my life. And I was thrilled when the President, probably against a lot of political advisers' better judgment, decided that this was important enough for him to assign a President's Commission to not just receive those reports and findings and put them on the shelf, but to followup with the call of reform as he did in December. And I certainly want to thank the administration for understanding, as has been stated here, how important this so-called industry, if it is an industry, but it is so massive, is to our economy; nearly 9 percent of the gross domestic products of this Nation, and that's incredible.

We can go through the details as to how the canary in the mine shaft is not doing well. We have seen the signs. We have had the cooperation from leaders on the Postal Service side like the Postmaster General, like chairman of the Board of Governors David Fineman, like the Treasury, and others, so many others who have detailed that. But suffice it to say that unlike our tendencies in Washington to react only in times of crisis, this is an instance when I don't think we can afford to wait, because by the time the crisis is upon us in its full-blown dimensions, our Nation, our economy will have suffered greatly.

So with the cooperation of leaders like the gentleman from Chicago, IL, Danny Davis, like the ranking member, Mr. Waxman, and others, we have tried to take this down a bipartisan path, which is what it should be, and all of their cooperation and understanding; and certainly Chairman Tom Davis for being gracious enough to figure out a way in which I could still stay involved in this and for taking the issue on full square has been a real demonstration of how Congress can work effectively and on a bipartisan basis.

So I look forward and certainly welcome our panelists here today, and I would just note for the record that today in Roll Call there is a full-page ad taken out calling upon this Congress to enact reform now because it's necessary. And although there is a lot of great names and associations here, I would like to just name a couple of the smaller ones: The American Bankers Association; American Express; Capital One; FedEx Corp., someone who provides a

lot of competition to the Postal Service; and an interest who understands the importance of the USPS to the Nation, International Paper; Magazine Publishers of America; National Federation of Independent Businesses; National Retail Federation; Time Warner, and on and on and on.

Those folks who understand that the economy of this Nation and the well-being and the way of life that the Postal Service has become for, as Senator Collins so accurately noted, well over two centuries is at risk if we fail to do the right thing, and that's why I am thrilled we are here for this historic meeting and look forward to the testimony of the witnesses. And with that, I'd yield back and thank the chairman.

[The prepared statement of Hon. John M. McHugh follows:]

OPENING STATEMENT
CONGRESSMAN JOHN M. McHUGH

JOINT COMMITTEE POSTAL HEARING
23 March 2004, 2:30 P.M.
2154 RAYBURN

Thank you and good afternoon. I commend the Chairman of our full Committee and welcome the Chair and Members of the Senate Committee. I think the fact that our two full Committees will spend an afternoon to discuss postal reform underscores the urgency and importance of the matter.

Indeed, in response to the President's call for reform in December, our Committee's Special Panel on Postal Reform and Oversight, which I chair, held three hearings in a two-week period to examine the need to modernize our nation's postal laws.

On January 28 the Panel heard from the Treasury Department, the Postal Service, the Postal Rate Commission, and the General Accounting Office. On February 5, the Panel traveled to Chicago, Illinois

for a hearing in which the Presidents of all postal unions and employee groups testified. The Panel held a final hearing on February 11 in which nine CEOs of competitors, commercial and nonprofit mailers, and postal reliant businesses testified.

All witnesses stated support for the Administration's broad principles on postal reform, and the hearings underscored that universal postal service is at risk and reform is urgently needed to minimize the danger of significant taxpayer bailout or dramatic postal rate increases. As the General Accounting Office emphasized, the Postal Service's current business model, formulated as it was in 1970, is no longer sustainable in the 21st century.

We've said it before and we'll say it again – and certainly our witnesses know it all too well – that the Postal Service is the center of a nearly $900 billion industry, employing nine million workers nationwide, and representing more than 8 percent of our nation's

Gross Domestic Product. Our Postal Service is in trouble and requires reform to preserve universal service and prevent a worsening crisis.

To understand the challenges at hand, one needs simply to read the testimony we received regarding the enormous liabilities still facing the Postal Service, the serious declines in mail volume and revenue, changes in the mail mix, increased competition from private delivery companies, declining capital investment, insufficient increases in postal productivity, uncertain funding for emergency preparedness, and major impediments to continued cost cutting.

While the problems are dire, I believe the President's principles for legislative change identify a path to some solutions. Fortunately, there currently exists a strong bipartisan basis upon which to proceed – including the highly refined bill that we developed in the last Congress with Representatives Davis,

Waxman, and Burton. Senator Carper has introduced an almost identical version of our legislation in the Senate.

The Postal Service is simply too important an institution – too important to the people of this nation; too important to our economy – to await the full brunt of a crisis that is clearly upon the doorstep. Indeed, there is good reason why this is the first Administration since President Nixon's to call on Congress to modernize our nation's postal laws. I remain hopeful that as Congress did in 1970, we too in 2004 will answer the President's charge and challenge.

I do believe that we must ensure any reform bill includes repeal of the escrow account created last year in the postal pension law. Failure to repeal the escrow in 2004 will create an unnecessarily high rate increase when the Postal Service files its case in the Fall. I look forward to hearing the Treasury Department's commitment to that matter.

Finally, I would like to note for the record that today's copy of Roll Call includes an advertisement in support of our Committees' efforts on postal reform, and it includes not just a broad array of mailers, but entities such as FedEx, NFIB, the Financial Services Roundtable, and employee groups like the National Rural Letter Carriers Association. I think the ad highlights what we learned in the Special Panel's hearing: that mailers, competitors, unions, and postal reliant businesses agree with the Comptroller General's statement: "Comprehensive postal reform is urgently needed."

Chairman TOM DAVIS. Thank you very much.

Ms. Norton, followed by Mr. Burton.

Let me just note for the record Members will have 7 legislative days in which they can submit any written statement, so you don't have to feel obligated, but we've had a lot of Members who have put a lot of work into this, and I want to give them the opportunity to make statements if they so desire.

Ms. Norton.

Ms. NORTON. Mr. Chairman, just let me briefly say that I think you are doing a public service to the Nation, you and Chairwoman Collins, in calling this hearing. In my judgment, this hearing may already be too late. Reading about the Postal Service is like reading about a failing business or shall I say a failed business, and that may be because it is not a business at all in the normal sense of the word. It is some kind of unique hybrid that Congress kind of pieced together, and we are paying the price for the kind of hybrid we put together. I mean, we act as though the Postal Service does not have tough competitors in the private sector, like FedEx and UPS. We act as though they don't have to provide universal service.

Yes, Ms. Collins will talk about the far reaches of Maine, because if you try closing a post office up in some sparsely populated part of Maine, they will be on her back saying, don't close my post office. That's the difference between the very successful private competitors and the Postal Service, and the Congress has acted as if there is no difference. And the results are here in the figures we see and in the prospects we have.

And what we see in some of these proposals, some of these proposals are indeed good, but some of these proposals read like what every failed business does. It tries to take it out on consumers and take it out on employees, and then, of course, you get completely torn-up labor relations. You try that in the post office, and I think it's not a very pretty picture.

And yes, you close post offices left and right. Let me tell you about my colleagues. They will all be calling Chairman Davis saying, not my post office.

I don't know what the answer is, but I know we have blinked this crisis, and we can't blink it anymore. We need a more radical vision than I see even in the proposals before us. The fact is that there is no self-respecting nation in the world that does not provide affordable postal service. We are coming to be that Nation, and we have to wake up, smell something. I'm not sure it's the coffee. And I'm not sure what we've been smoking, but we are very late to try to do something about the oldest Federal agency in the United States.

Thank you, Mr. Chairman.

Chairman TOM DAVIS. Thank you very much.

Mr. Burton.

Mr. BURTON. Thank you, Mr. Chairman.

Mr. Chairman, I have been on the Post Office and Civil Service Committee, I know I look a lot younger, but for 20 years, and—don't I look a lot younger? I thought I did. But anyhow, when I first became a member of the committee, we didn't have this kind of a crisis, but with electronic messages being sent, with the faxes being

sent, we've seen a deterioration of the revenues coming in to the Postal Service, and they are really suffering on difficult times. And we are looking at unfunded obligations now of about $90 billion.

And I'd like to have my whole statement submitted for the record.

[The prepared statement of Hon. Dan Burton follows:]

Opening Statement
Chairman Dan Burton
Committee on Government Reform
Special Panel on Postal Reform and Oversight
Title: "The Postal Service in Crisis: A Joint Senate-House Hearing on Principles for Meaningful Reform"
Date: March 23, 2004

Mr. Chairman, I want to thank you for holding this hearing this afternoon and continuing to move the debate over the future of the United States Postal Service forward. As a veteran of the old committee on Post Office and Civil Service, I have been active on postal issues for many years, and I have been frustrated by the inability to resolve the complex and thorny issues surrounding postal reform.

The crisis is here and the time for change is now. The President's Commission on the Postal Service currently estimates the Postal Services debts and unfunded obligations to be around $90 Billion. In addition, in 2001, the General Accounting Office placed the Postal Service on its list of high-risk institutions because of its financial problems. A massive taxpayer bailout looms on the horizon if we do nothing to resolve the crisis.

The Postal Service remains mired in a regulatory and management model that is nearly three decades old and does not provide the Service with the flexibility it needs to succeed in a rapidly changing market. The United States Postal Service has been a cornerstone of the U.S. economy for over 200 years. Currently, the Service supports an $871 billion industry employing 9 million workers nationwide, and representing more than 8 percent of the Gross Domestic Product.

Mail volume has declined during each of Fiscal Years 2001, 2002 and 2003. Conversely, the number of addresses to which the Postal Service delivers has increased by 5.2 million during the same three-year period. On-line bill paying, the anthrax mailings, and the sluggish national economy of the post-9/11 era, are other factors that have contributed to the Postal Service's declining revenues. Overall, the Postal Service has lost $2.3 billion in the last three years. Under the Postal Service's 30-year-old legal framework, the only response to declining volume and revenue is larger and more frequent rate increases, contributing to what GAO has called a "death spiral." If Congress fails to pass postal reform this year, a crucial sector of the U.S. economy will be exposed to serious harm and consumers and business alike will be saddled with higher stamp prices unnecessarily.

One issue makes passage of postal reform legislation immediately urgent is the escrow account created by the Postal Civil Service Retirement System Funding Reform Act of 2003. The law, which was quickly passed by the House and Senate without dissent, was in response to a surprise finding by the Office of Personnel Management that future payments by the Postal Service into the Civil Service Retirement Fund would over fund the Service's retirement obligation by approximately $71 Billion. Seventy-one billion dollars represents a substantial amount of savings but it does not solve the fundamental

flaws in the Postal Service' business model, at best the savings can provide the Service a degree of breathing room, if we allow the Service to constructively use this money.

At present though, the Service cannot use this money. Because, in addition to debt reduction and holding postal rates stable in the short-term, the Act requires the savings that accrue after Fiscal Year 2005 to be held in escrow until Congress tells the Postal Service what to do with the money. While the Postal Service is required to make recommendations to Congress regarding what to do with the escrow funds the ultimate responsibility for what to do with the money rests squarely on the shoulders of the Congress and not the Postal Service.

If we continue to talk about Postal Reform rather than act, what will happen is that the Postal Service will be required to file a rate case late in 2004, which could raise rates an additional 5.4 percent to fund this escrow account, on top of whatever rate increases are necessary just to fund general postal operations.

I think that we all agree in principle that this escrow account should be dissolved and the money put to better uses. I think we all agree that some of the funds should be used to fund postal service retiree health care benefits which are currently a huge unfunded liability hanging over the Postal Service. The only thing we seem to disagree on is how we resolve the budget implications of dissolving this escrow account. We should not let this one issue distract us from the larger business at hand.

The crisis facing the Postal Service is too severe to resolve through piece-meal efforts. The solution is comprehensive reform, and we need to remain focused on that goal. Arriving at that solution is going to take compromise and everybody is not going to be completely happy with the final product. However, to wait until we have a perfect reform proposal rather than moving forward on a good reform proposal would be irresponsible and a disservice to both postal employees and the American people.

So, in closing I want to thank you once again for holding these hearings. They have been an extremely valuable starting point, and I hope that we can build on what we have heard, and all work together in a bipartisan way to finally enact serious and meaningful postal reform. The alternative, as I've said, would be a disaster.

Chairman TOM DAVIS. Without objection.

Mr. BURTON. And something has to be done. You know, last year Congressman McHugh and I and others worked very hard to get a postal reform bill passed, and we ran into a few impediments, not the least of which was members of the private sector in this country who want to take over a large part of the Postal Service's business doing everything they could to stop postal reform.

We are at a point now, in my opinion, where we have to do something. We should have done it last year. We should have done it before that. But it's getting so bad now that I think that the Postal Service is in danger of going belly up, or the taxpayers are going to have to pay a huge amount of money to bail out the Postal Service. And so something has to be done.

I know there's going to be a lot of political pressure, Mr. Chairman, from various entities in the private sector saying, you know, we don't want postal reform, and the main reason is because they want to—they want more market share. And I understand it's competition, they want to get more business, but we can't let that be the reason that we see the postal system in this country be altered into a situation where it's irreparably damaged and the American people suffer. So we have to do something.

Congressman McHugh has done yeoman's service on this, as you know. I applaud you and Senator Collins and her colleagues in the Senate for making this a top priority, and I really am happy that the administration is making this one of their main objectives this time. We have to do something. If we don't, there's going to be major postal rate increases. The deficit in the Postal Service is going to continue, and the Postal Service as we know it is going to be in peril. Something has to be done, and I am glad, Mr. Chairman, you're taking on this mantle of leadership right now along with Senator Collins to make sure we get that job done.

Chairman TOM DAVIS. Thank you.

I'm glad to have you working with us, Chairman Burton. I think if we'd been able to get assurances in moving this to the floor in the last Congress, we would have gotten it out of committee. This time I think we have that with the impetus from the administration if we can move it through the committee.

Secretary Snow has a limited period of time with us, so what I'd like to do right now is swear all of the panel in, hear from Secretary Snow, have him take questions from each side briefly before he has to go, and I understand that Mr. Roseboro will be here to answer questions after we address the panel, and then we will go on with opening statements and try to fit them in appropriately, if there's no objection to that.

Would the panel please rise with me as I swear you in.

[Witnesses sworn.]

Chairman TOM DAVIS. Mr. Secretary, thank you very much for your service to the country, and thank you for taking the time to be with us this afternoon.

STATEMENT OF JOHN W. SNOW, SECRETARY, U.S. DEPARTMENT OF THE TREASURY, ACCOMPANIED BY BRIAN C. ROSEBORO, ACTING UNDER SECRETARY FOR DOMESTIC FINANCE, U.S. DEPARTMENT OF THE TREASURY

Secretary SNOW. Thank you very much, Chairman Davis, and Chairman Collins and distinguished members of the panel. I am delighted to have the opportunity to be with you today to address this overdue subject and this critically important subject.

Let me say I thank you for your flexibility in accommodating me. I wanted to be here, and appreciate your allowing me to come in light of the fact that I may not be able to stay the whole time. But as you said, Under Secretary Brian Roseboro, who is very knowledgeable on this subject, can speak well in my absence.

I am here because I want to underscore the Bush administration's commitment to the objective of a strong, comprehensive postal reform. As you said, Congressman Burton, we can't wait 20 years to get this done. We really need to get it done now. It's widely acknowledged by everybody who looks at the question that the business model of the Postal Service just doesn't work anymore. It's not sustainable in light of all the technological changes and changes in the marketplace and substitutes that have come along. We need a new model.

The President recognized that and sought to help the debate by establishing a commission, which—a bipartisan commission to look into the question of what could be done to put the Postal Service on a sound financial footing so it could operate well into the 21st century and serve those important objectives that were mentioned in your comments. That commission issued its report in July, and it's, as we think about it at the Treasury Department, the most important document on the Postal Service in 30 years. And I certainly take my hat off to the members of that Commission, who did really first-rate work in producing their recommendations.

I wouldn't say that we endorse every 1 of the 35 recommendations, but we believe the report as a whole is a critical building block for the reform effort. And, of course, the leadership of these two committees is critical in making that happen.

We would suggest that comprehensive postal reform ought to be what we are seeking, and it ought to be guided by five broad precepts or principles implementing best practices, and enhancing transparency of operations, providing for greater operational flexibility, fostering greater accountability and ensuring self-financing. And encompassed within these larger principles, there are three specific issues of great interest to the administration and, I know, to members of the committees, because I have spoken to some of you about this.

The first is the appropriate allocation of the Civil Service Retirement System military costs, a second is meeting the break-even mandate, and a third is making sure there's accurate cost accounting.

Congress called on the Postal Service to achieve self-financing when it passed the Postal Reorganization Act in 1970, and this principle must be a cornerstone of any postal reform that's pursued today. In order to meet the self-financing mandate, we think that the postal—that the pension cost for military service of Postal

Service employees should be attributed to the Postal Service rather than to the U.S. taxpayers. Congress demonstrated that it shared this belief when it passed the Postal Service—Postal Civil Service retirement legislation in 2003.

We would oppose any effort to shift the roughly $27 billion of pension costs connected with military service back to the taxpayers. This position, in our view, represents a fair and equitable allocation of those pension costs. It represents good government, good practice, and is financially prudent.

With respect to another issue that I know is on the mind of many of you, the act's provision establishing the escrow account, it is important, I think, to start by noting that the administration never advocated including that provision in the final bill. And I'd say that we are prepared to work with you toward a modification of the Postal CSRS Funding Reform Act, abolishing the escrow in a way that will not have a serious adverse effected on the deficit, as long as it's part of a good overall postal reform bill. So we would look forward to working with you on that.

Second, an accurate assessment of the Postal Service's financial performance must reflect all of its liabilities, not just some of them, including any unfunded liabilities not currently reflected on the balance sheet as well as all taxpayer-funded appropriations.

Finally, we suggest that comprehensive postal reform must require the Postal Service to present more accurate revenue and cost allocations. Currently the Postal Service attributes 42 percent of its total costs to general overhead, only allocating 58 percent of its costs across product lines. That makes it tough to run the business well if you can't allocate your cost to the specific services for which those costs are generated. And while we recognize that cost attribution can be complicated for any company, particularly a company of the size and complexity of the Postal Service, we think that a more accurate cost attribution is possible, and that by getting it, we could get costs and prices and profitability into better alignment.

In our view, the Congress has a unique opportunity to take decisive action here, to craft a comprehensive postal reform bill that can lead to a more successful operation of the Postal Service. We continue to appreciate and endorse the effort and dedication of the Postal Service employees, its management, the Board of Governors, all of whom have made tremendous contributions to this organization, and Postmaster General in particular. I understand, and I want to compliment the Postmaster General for this, that the Postal Service is implementing all 16 recommendations of the President's Commission that don't require prior congressional action. That's much to be commended.

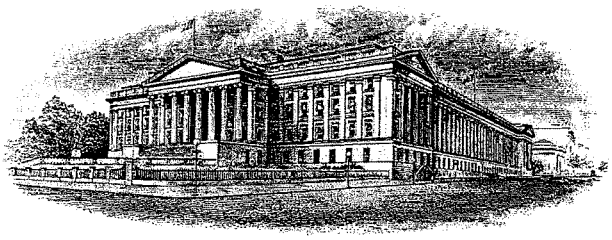
Let me close by saying that the administration is anxious to work with you to craft a reform bill framed in accordance with these principles that I outlined. We recognize that it will require shared sacrifice from everybody, from all the shareholders, but we have an opportunity here to put in place something that will stand the test of time in this enormously dynamic market.

So I regret that I won't be able to be with you for the full length of the hearing, but I do look forward to being part of the effort to

bring about significant, far-reaching, comprehensive postal reform. Thank you.

Chairman TOM DAVIS. Thank you, Mr. Secretary.

[The prepared statement of Secretary Snow follows:]



DEPARTMENT OF THE TREASURY
OFFICE OF PUBLIC AFFAIRS

FOR IMMEDIATE RELEASE
March 23, 2004

Contact: Anne Womack Kolton
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HEARING TESTIMONY
THE HONORABLE JOHN W. SNOW
SECRETARY OF THE TREASURY
ON REFORM OF THE UNITED STATES POSTAL SERVICE
BEFORE A JOINT SESSION OF THE
COMMITTEE ON GOVERNMENT REFORM
UNITED STATES HOUSE OF REPRESENTATIVES
AND
COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE
MARCH 23, 2004

Chairman Collins, Chairman Davis, Ranking Member Lieberman, Ranking Member Waxman and distinguished members of the House and Senate Committees, thank you for the opportunity to testify today on the need for comprehensive postal reform. I welcome this opportunity to underscore the Administration's interest to support a principled approach to enacting comprehensive legislation to reform the United States Postal Service.

The Postal Service's Important Role in America's Economy and Life

The operations of the Postal Service touch virtually every individual in every American household. In many ways, the Postal Service serves as a sort of "human face" of the federal government. It performs a critical service, and it performs it well. I also recognize that the USPS is an enormous business, focusing on sorting, transportation, and delivery on a massive scale. As one of the largest businesses in America, the operational challenges connected with this organization are many. I also bear in mind that the Postal Service provides careers for more than 700,000 individuals. As its most valuable assets, issues connected with the Postal Service's labor force must be carefully considered. Finally, as has been frequently pointed out in the past, the Administration's focus on the

Postal Service has a much wider application in our country's economy. While important in and of itself, some industry estimates associate the Postal Service with a much larger mailing industry – estimated to be a $900 billion industry, employing 9 million workers and responsible for as much as 8% of the GDP.

It is widely acknowledged that the current business model of the Postal Service is not sustainable going into the 21st century. Electronic diversion of mail volumes has caused a substantial and likely irreplaceable decline in first class mail. This trend is expected to continue. The Postal Service ended the latest fiscal year with large on and off-balance sheet liabilities. These liabilities include $7.3 billion of debt owed to Treasury, $7.1 billion for unfunded workers' compensation costs, $8.7 billion for operating leases, $5.8 billion for unfunded pension liabilities, and approximately $60 billion for unfunded post-retirement healthcare liabilities. For a business that has a statutory mandate to be self-financing and to break-even, the Postal Service has accomplished neither.

The Administration's Response

The Administration has already demonstrated clear support for comprehensive postal reform. To his credit, President Bush took the initiative to create a bipartisan Commission to examine what steps might be taken to put the Postal Service on a sound financial and operational footing well into the 21st century. In the short seven month period of time provided to the Commission by the President, the Commission submitted a report containing 35 recommendations that spanned a wide variety of areas, which is a critical building block to achieve postal reform.

It is worthy to note that the 16 out of the 35 recommendations are assigned to the Postal Service for immediate action. This is evidence that there is wide latitude already provided to the Postal Service, according to relevant statutes, to operate in a manner that will result in ever better operational and financial performance.

However, there are many important recommendations of the Commission that will require Congressional action. I wish to give credit to you, Chairman Collins and Chairman Davis, as well as to your colleagues, in particular Congressman McHugh, for dedicating an abundance of time and effort in conducting public hearings and seeking an optimal approach to legislative change that is clearly urgently needed. Your leadership is critical to a successful next step in reforming the Postal Service.

I want to reiterate the Administration's goal to support a comprehensive postal reform act during 2004 that is characterized by the five principles articulated by the White House last December: implement best practices; enhance transparency; provide for greater operating flexibility; foster greater accountability; and ensure self-financing. I note with some pleasure that these five principles are widely endorsed by members of these committees, the Postal Service, and by the many stakeholders in the mailing community. Following its review of written testimony and other public comments, the Administration has great confidence that there is broad, general, consensus in the diverse stakeholder community on what elements of reform are "must haves."

Rather than discuss a wide range of issues today, I would like to focus my testimony on three particular issues that, having reviewed the testimony of previous hearings in the House and Senate, are matters of great interest to the Administration: allocation of Civil Service Retirement System (CSRS) military costs; considering the break-even mandate; and cost allocation.

Ensuring Self-Financing
CSRS Funding Reform: Allocation of Military Costs

The Administration believes that comprehensive postal reform must require the Postal Service to cover all of its financial obligations, including its on and off-balance sheet unfunded liabilities, as well as other liabilities. This is consistent with the requirement that the Postal Service be self-financing and ensures that the Postal Service will remain motivated to operate in a manner that strengthens the financial and operational health of the Postal Service. Taxpayer bailouts should not be the future of the Postal Service.

Public comments by some members of Congress and others in the mailing community with respect to reversing the current allocation of pension costs for military service in the Postal Civil Service Retirement System Funding Reform Act of 2003 (hereafter "the Postal CSRS Funding Reform Act"), P.L. 108-18, suggest that further clarity on the Administration's intent is warranted.

While this is, indeed, a complicated topic, I believe it is important to comment on it because the Administration adopted the principle of "ensuring self-financing" with this particular issue very much in mind. To its great credit, the Congress enacted the Postal CSRS Funding Reform Act quickly and crafted it appropriately with respect to attributing military costs. The Administration opposes any effort to shift the estimated $27 billion of military costs back to the taxpayer.

The decision to allocate retirement costs connected with military service to the Postal Service is justified by three principled arguments: this is a fair and equitable allocation of costs, it represents good government, and it is financially prudent. Each argument, by itself, is compelling. Taken together, this is a persuasive set of arguments that serves to endorse the original decision of Congress in the Postal CSRS Funding Reform Act.

As a starting point, it is important to note that no other federal agency has ever received the benefit of a dynamic analysis of its investment flows, as was the case for the Postal Service. It provided the Postal Service with a properly calculated, enormous gain of $78 billion at the expense of other CSRS participants.

Fair and Equitable

This allocation is fair and equitable because the Postal Service, as mandated in the Postal Reorganization Act signed in 1970, is obliged to manage its finances in a manner that ensures that it covers its costs, unlike virtually all other federal agencies. Furthermore, it

is fair and equitable because the Postal CSRS Funding Reform Act created a funding system, akin to the funding system currently utilized for the Federal Employee Retirement System (FERS), which requires each agency to cover pension costs connected with military service (rather than Treasury). Finally, it is fair and equitable because the Postal Service has also been the beneficiary of significant taxpayer funded appropriations, which more than cover the attribution to Postal of the $27 billion of military costs. During a period when the Postal Service has a statutory mandate to be self-financing, the Postal Service's cumulative performance has been bolstered enormously and in an extraordinary way by taxpayers, and as a direct benefit to ratepayers.

Good Government

The Postal CSRS Funding Reform Act provides us with a postal pension methodology grounded in pension funding principles that are characterized as "best practices." This is a "good government" initiative. The new system replaced a system of funding postal pensions that Congress developed in a piecemeal fashion, and which never conformed to good funding principles. With Congressional leadership in the Postal CSRS Funding Reform Act, we adopted a system to drive full funding for FERS and full funding for postal CSRS.

There are a number of voices that advocate a return of these obligations to the taxpayer because the impact on the federal budget deficit can be minimized by having the Postal Service allocate these funds to cover other currently unfunded retirement obligations. Choosing to emphasize a negligible net budgetary impact rather than concentrating on the fact that real economic costs are being transferred from ratepayers to taxpayers can serve to cloud the fundamental issue. Good government dictates that we consider this as a real economic cost, dollar for dollar, no matter how these funds might be accounted for in the federal budget.

In short, last year's legislation was never intended to put the Postal Service in the same situation as other federal agencies, and we ought not to try to do that now, either. Rather, it was an appropriate "good government" response to an alternative funding methodology brought to our attention. It was not intended as a "break" for the Postal Service, or to provide the Postal Service a discount from their real costs.

Financially Prudent

This issue is best considered in the wider context of the federal government's retirement funding system. Choosing to treat the Postal Service in a manner that is inconsistent with the FERS funding paradigm has implications to the wider government retirement structure. By so doing, the door is opened to tinker with FERS across agencies, as it will be difficult to conclude that the Postal Service is the only exception to an otherwise consistent retirement system. The costs are likely to be enormous in their entirety.

The Escrow Provision in the CSRS Funding Reform Act

With respect to the Postal CSRS Funding Reform Act's provision establishing an escrow account, it is important to note that the Administration never advocated including this provision in the final bill. The Administration is willing to work toward a proposed modification of the Postal CSRS Funding Reform Act abolishing the escrow that will not increase the deficit.

Ensuring Self-Financing
The Break Even Mandate

We find recent statements claiming that the Postal Service is nearly at a financially break-even position as mandated by the Postal Reorganization Act to be somewhat misleading. By limiting its analysis to the reported accounting results, the Administration could agree that the cumulative losses in the Postal Service's retained earnings account might be covered by the end of this fiscal year (thanks to the Postal CSRS Funding Reform Act). However, we would argue that a more accurate assessment of the Postal Service's financial performance should also include taking into account unfunded liabilities it has incurred but may or may not be included on its balance sheet, as well as all taxpayer-funded appropriations received.

Revenue and Cost Allocation

I would also stress the importance of precise revenue and cost allocation across products as a key element to include in any successful postal reform. We do not believe that the current ability of the Postal Service to allocate costs across products to a 58% tolerance level, thus attributing approximately 42% of total costs to general overhead, is close to being satisfactory. In our view, this large unallocated portion is a sort of "elephant in the room" that forces stakeholders, employees, competitors, the regulator, Board of Governors, USPS management and others to invest substantial time, energy, and expense calculating, debating or contemplating a myriad of important issues. While we recognize cost attribution can be complicated for a company the size and complexity of the Postal Service, we do not agree with those who contend that it is not possible to drill down to a much finer cost allocation.

In the case of the Postal Service, the public interest and trust demands the level of transparency and accountability that we are calling for. We do not believe that confidentiality concerns of the private sector should be applied to the Postal Service. On the contrary, in fact, the scope of postal reform requires true and exacting transparency.

Conclusion

The Congress has a unique opportunity during the next months to take decisive action to craft a comprehensive postal reform bill that can be instrumental in helping the USPS operate more successfully. Thank you for the attention you are paying to this critical aspect of our country's economy and life. We continue to appreciate and endorse the effort and dedication that the Postal Service's employees, management, and Board of

Governors invest into implementing its Transformation Plan and those recommendations posited by the President's Commission on the United States Postal Service. The Administration remains prepared to actively work with you to craft a comprehensive reform bill that will stand the test of time in an enormously dynamic market. We believe it critical that reform legislation result in a sharing of sacrifice from all stakeholders, and characterized by the five principles we have articulated.

Once again, I thank you for your kind invitation to appear today. I would be grateful if you would direct your questions to Acting Under Secretary for Domestic Finance, Brian Roseboro, who will be pleased to respond.

Chairman TOM DAVIS. I know you need to leave in a couple of minutes. I wonder if you could just try to stay for a couple of minutes and answer some questions, or if you can deflect them to Secretary Roseboro if you think that's more appropriate. But I wanted to recognize Senator Collins.

Senator COLLINS. Thank you, Mr. Chairman.

Secretary Snow, over the past several months that we have been holding hearings, we have heard from many different parties expressing many different views. We've heard from the Postal Service unions, the associations, the CEOs of major companies such as Time, Inc., and RR Donnelly. We have heard from representatives of the newspaper and direct marketing associations, and they have very different views in some cases on what should be done. But there were two issues that united every single witness who has testified before our committee at these six previous hearings, and that is the two issues that they all have in common are a desire to see the escrow account repealed and the return of the military pension obligation to the Treasury Department.

This morning, or this afternoon, rather, you have praised and justifiably so, the fine work of the President's Commission, and as you're well aware, those recommendations were part of the Commission's recommendations as well. So the administration's is a pretty lonely voice on those two issues.

I do recognize that the bill that the administration proposed to correct the overfunding of the pension system did not include an escrow account, because I introduced the administration's bill. I don't understand why today you have said that removing the escrow account, which was not part of administration's original bill, must be done so in a deficit-neutral position. This is an overfunding that the OPM and OMB identified and which we have corrected. It doesn't make sense to lock up that money and prevent the Postal Service from using it.

That's my first concern, and then if there's time, I'd like to turn to the military pension issue.

Secretary SNOW. Well, as I understand it, that's roughly $3 billion in the escrow account today. And——

Senator COLLINS. Well, the escrow account grows in future years if we don't remedy this problem.

Secretary SNOW. I would agree. Right. Right. But that is money that, as we keep score on the Federal deficit, goes into the plus column today. And if the moneys are allowed to flow out of the escrow account, they would be charged against the deficit and add $3 billion to the deficit. That's the basic issue we have with the escrow account. And as I say, I'd be willing to work to find an offset for the $3 billion, but we'd be much happier about the prospect of the escrow account solution you want if there were an offset.

Senator COLLINS. Secretary Roseboro, did you want to add to that?

Mr. ROSEBORO. Oh, yes. Just consistent with the Secretary's remarks, anything that increases the budget deficit increases the burden on taxpayers, and that is just fundamentally inconsistent with the principle the President has laid down in terms of the Postal Service being self-financing, as well as the original principle of postal reform from the early 1970's of Postal Service being self-fi-

nancing. So as indicated, while we recognize the difficult accounting nature of dealing with this particular aspect, we would prefer to focus on economic exposure and how that could be adversely effective on the taxpayer. But we will be more than willing and anxious to work with the committee to find some type of resolution to the problem.

Senator COLLINS. Well, I'm eager to work with you to resolve this issue, because I think it's absolutely critical, but it really is not relevant to the break-even mandate of the Postal Service. This was legislation that corrected an overfunding by the Postal Service to the retirement system. So to say that we have corrected that, but then we are locking up the money and not allowing it to be spent to fund retiree health care benefits, pay down the debt to the Treasury, or to remove the need for a dramatic increase in postal rates, for example, just doesn't make sense to me. It contradicts the entire purpose of the legislation that we passed at the administration's request last year.

Secretary SNOW. Senator, we don't disagree in principle. We do have that issue of a $3 billion hit to the accounts of the United States, and, as I said, we're prepared to work to try and find some offsets for that. But in principle we're not disagreeing with you.

Senator COLLINS. I see that I have 3 seconds left, so I will yield back the balance of my time and hope that the military pension issue will be addressed by others. Thank you, Mr. Chairman.

Chairman TOM DAVIS. Mr. Davis.

Mr. DAVIS OF ILLINOIS. Thank you very much, Secretary. I'll just ask one question in terms of along the same lines. If we should shift the military retirement cost to the ratepayers, and if we can't shift it to the taxpayers, then more than likely it gets shifted to the ratepayers. Would that not put the Postal Service in the worst shape in terms of perhaps negating the possibility of some business that could be done that would not be done?

Secretary SNOW. Congressman, you raise a good point. How would the $27 billion be amortized or dealt with? This is something that Under Secretary Roseboro has looked at. In broad outline it would have to come through greater efficiencies, perhaps some phasing in of some pricing increases over time. But as we look at the situation, there are considerable opportunities, and I think the Postmaster General would agree, considerable opportunities for further efficiencies within the organization itself that would absorb some considerable part of those costs. But my learned colleague can give you a better answer than I can on that, and I very much apologize.

Chairman TOM DAVIS. Thank you. We know you've got to run, and we appreciate very much. Thank you for your time.

And, Mr. Davis, I think what I want to do, if it's OK with you, is go on before we proceed; everybody's sworn, see if any other Members, want to make opening statements, and let's move that out of the way, and then we can get to the testimony of the rest of the panel.

And, Mr. Roseboro, I'll just have some cleanup work to do following that, some questions from some of the panel members.

OK. Mr. Ruppersberger.

Mr. RUPPERSBERGER. Mr. Chairman. Thank you, Mr. Chairman and Senator. It's great to have you here and join together in this bipartisan issue.

We're here today to explore what legislative changes are necessary to ensure the U.S. Postal Service continues to serve the best interests of the American public, but because the Postal Service is a $900 billion industry, it employs more than 9 million people, we can all agree our objective is to stabilize the Postal Service and secure its future.

As we consider options for reforming the U.S. Postal Service, it is crucial to recognize our Nation's shifting economic, commercial and technological conditions. Hard-copy communications have been affected by the use of fax machines and a variety of electronic communications including the Internet. The U.S. Postal Service faces increased competition, as we know, from private delivery companies and also the challenges of operating during an economic slump. Mail volume has declined during each of the fiscal years 2001, 2002, 2003, and the Service has lost $2.3 billion in the last 3 years.

The financial problems of the postal industry, however, must not be imposed on the backs of the men and women who have made the U.S. Postal Service the best postal service in the world. As our national unemployment rate continues to decline, we must protect the job security of postal employees, including the retirement, health benefits and Workers' Compensation.

In addition, we must consider the impact of the postal reform on individuals and small businesses. Cutbacks on services, charges and delivery, and post office closures could unfairly burden our communities both rural, suburban and urban.

Last we must not overlook the U.S. Postal Service's uncertain funding for emergency preparedness. It has been more than 2 years since our country was brutally attacked by the terrorists on September 11, 2003, and other issues involving anthrax. We live in an era of uncertain threat levels and must ensure the U.S. Postal Service has the resources to keep their employees, our families and our communities safe.

Chairman TOM DAVIS. Thank you very much.

[The prepared statement of Hon. C.A. Dutch Ruppersberger follows:]

Hon. C.A. Dutch Ruppersberger
Committee on Government Reform
Joint Senate-House Full Committee Hearing
"The Postal Service in Crisis:
A Joint Senate-House Hearing on Principles for Meaningful Reform"
March 23, 2004 2:30 PM
Room 2154 Rayburn House Office Building

Statement

Mr. Chairman, thank you calling this hearing on the need for reform of the United States Postal Service. We are here today to explore what legislative changes are necessary to ensure that the U.S. Postal Service continues to serve the best interests of the American public. Because the Postal Service is a $900 Billion dollar industry that employs more than nine million people, we can all agree our objective is to stabilize the Postal Service and secure its future.

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of Fiscal Years 2001, 2002, and 2003, and the Service has lost 2.3 billion dollars in the last three years.

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In addition, we must consider the impact of postal reform on individuals and small businesses. Cutbacks on services, changes in delivery and post office closures could unfairly burden our communities.

Lastly, we must not overlook the U.S. Postal Service's uncertain funding for emergency preparedness. It has been more than two years since our country was brutally attacked by terrorists on September 11, 2001. We live in an era of uncertain threat levels, and must ensure the U.S. Postal Service has the resources to keep our families and our communities safe.

Chairman TOM DAVIS. Any other Members? Ms. Miller, you want to make an opening statement?

Mrs. MILLER. Thank you, Mr. Chairman. I'll be brief. I certainly appreciate your commitment to reforming the postal system.

I'd like to thank my esteemed colleague from New York. I saw Mr. McHugh; didn't realize he had a 9-year sentence to postal reform here. So we're looking forward to a successful conclusion of all of that, and I certainly would like to extend my thanks to Senator Collins for joining us today, and certainly her commitment as well as the President's. I am certain with all of us, we can get reform—a reform initiative signed into law before the end of the year.

You know, the Postal Service is such an important element of our society, as everybody has said here. It's actually over 8 percent of the Nation's gross national product, which is a startling number, and certainly individuals and businesses rely on it each and every day. And for this reason, any consideration of reform certainly has to be sensitive to the needs of consumers, both individuals and businesses.

In addition, I think that the reform needs to be sensitive as well to all of our postal workers, and I don't think that can be stressed enough. These are the people who make sure that your magazines are arriving in your home or your apartment or what have you every single day, that they show up every week. They make sure your bills are paid on time. These are the people that really make it work. And sometimes I think that we take our postal workers and our service for granted there, but I certainly want to thank the men and women who work every day to make it so reliable.

And I do think sometimes we have a tendency to want to say that the Postal Service is a very large and inefficient government bureaucracy, but I think when you think for 37 cents I can put something in the mail in Macomb County, MI, where I live, and in several days it'll arrive anywhere in the continental United States, I think that's really remarkable.

So I think it's important to note that the Postal Service is not broken, but it needs to be improved. And I think the largest room no matter what business you're involved is certainly the room for improvement.

So I want to thank all the witnesses who are testifying today. I look forward to working with all of you.

Thank you, Mr. Chairman.

Chairman TOM DAVIS. Thank you very much.

Mrs. Blackburn.

Mrs. BLACKBURN. Thank you, Mr. Chairman. And thank you to Senator Collins for coming to join us today.

I have a statement that I will give for the record, but just very briefly to touch on a couple of things. I do want to thank our witnesses. And I want to thank the members of the Postal Service, the employees of the Postal Service from my district who care deeply about reform and have come to join us today.

We are all concerned with what we have seen happen with the Postal Service's financial health over the past decade and the deterioration that has taken place there, and I think as we have held the hearings in the House and the Senate, there are three areas where we have looked at that are in need of crucial reform.

First, the Postal Service must develop a 21st century business model. And the Service is operating in 2004 as it did in the 1970's, and we know that is very difficult for the Postal Service and for the taxpayers.

Second, the Postal Service must have financial transparency. And proper financial management enables executive officers to make sound financial decisions, and it allows new reforms to take hold, and that is something that is essential. And also, we think that it is essential that an extensive independent audit must be taken as soon as possible so the Postal Service can be held accountable for its operations, and the waste and inefficiencies can be identified and targeted for elimination.

And third, the Postal Service must contain its labor costs. Eighty percent of its total expenses for last year were for labor, and this stands in stark contrast to some of the commercial mailing enterprises which we have heard from during the course of our hearings.

Again, I want to thank the chairman for his leadership, and I want to thank our witnesses for being here today, and we look forward to working with you and hearing your testimony.

Thank you, Mr. Chairman.

Chairman TOM DAVIS. Thank you.

[The prepared statement of Hon. Marsha Blackburn follows:]

Marsha Blackburn Opening Statement
March 23, 2004
Postal Reform Hearing

The United States Postal Service delivers billions of mail pieces a year for more than 200 million customers. With a budget of nearly $69 billion, the USPS is America's largest public enterprise.

For 225 years, the postal service has been there, playing a vital role in our nation's development - linking a rapidly growing, sprawling nation from coast to coast, keeping us in touch with the outermost corners of our country.

The Postal Service has evolved throughout the years. The most recent changes, in 1970, went to the heart of the USPS with reforms based on a business model - improving productivity, increasing self-sufficiency, and reducing Federal government involvement in the Services' operations.

However, in the last decade, we have watched as the Service's financial health has deteriorated to a point where either the federal government will be forced to provide a bailout or accept an enormous rate increase that will be passed onto customers. In both cases, American taxpayers will have to foot the bill.

Last summer, a presidential commission examined the Postal Service and recommended that agency level and legislative reform actions be taken. These reforms would keep the Service financially solvent for the next decade; offsetting the cost of higher rates or higher taxes on America's taxpayers-customers.

Many of the commission's recommendations incorporate the basics of running a successful business, and the Postal Service must transform its business practices to reflect these recommendations.

During hearings held by both the House and Senate, 3 areas were clearly identified as being in critical need of reform.

1st, the Postal Service must develop a 21st century business model. The Service is operating in 2004 on a model developed during the 1970s - no business would or could remain static for so long and not go out of business. That model no longer functions satisfactorily in today's fast-paced technology world.

2nd, the Postal Service must have financial transparency. Proper financial management enables executive officers to make sound financial decisions, and it allows new reforms to take hold.

Also, a complete and accurate picture of the USPS' financial operations must be available to Congress, postal management, and postal regulators. Therefore, an extensive, independent audit must be taken as soon as possible so the Postal Service can be held accountable for its operations and waste and inefficiencies can be identified and targeted for elimination.

3rd, the Postal Service must contain its labor costs. 80% of its total expenses for last year were for labor. This stands in stark contrast to commercial mailing enterprises that spend only 30 to 50% of their expenses on labor.

As this committee listens to today's testimony and works toward a legislative proposal to address postal reform, I must emphasize that postal reform is needed now. On behalf of millions of Americans and thousands of small businesses, we must fix what is broken with the Postal Service so that universal mail service will be there for future generations - and not at exorbitant rates or with extensive government subsidy.

I want to thank all the witnesses for being here today. Thank you for the work you do, and I look forward to hearing your testimony.

Chairman TOM DAVIS. Senator Carper and then Mr. Clay.

Senator CARPER. To our colleagues here in the House of Representatives, to my Chairman Susan Collins, it's great to see all of you. To our witnesses, especially our General, thank you for being here today. I remember walking in this building, gosh, how long ago was it? 1965. 1965, when I was a freshman at Ohio State University, Navy ROTC, midshipman, and we were—spring break. I didn't have enough money to go to Florida for spring break, and I ended up taking a free, all-expenses-paid trip to Quantico, VA.

To see if I wanted to grow up and be a Marine officer. I ended up—I enjoyed the trip. I have great respect for the Marines and still do. But I enjoyed the trip. I just wanted to have a chance to maybe get out of Quantico one afternoon to come to Washington, DC, and, lo and behold, I did.

And a bunch of my buddies and I got on a train in Quantico and came on up here to D.C. They went up to Georgetown to get in to trouble, and I came to Capitol Hill and ended up wandering into this building, in spring break of 1965.

And there was a hearing going on. Everything else was shut down around the Capitol. There was a hearing going on in this building, I think on this floor, just down the hall. It was a Judiciary Committee hearing, and I think the chairman was a guy name Emmanuel Celler, I think he was the chairman. And they were having hearings on the Voting Rights Act of 1965. That was my introduction. I said, when I left, to my colleague, Ed Towns, with whom I came here in Congress, I said, when I left that day to go back to Quantico with my buddies, I said, did you guys have a good time? They had a great time in Georgetown. They wanted to know if I did too, and I said yep. But some day I would like to come back and work in this town, and it is great to be back in this building where we all started several decades ago.

Well, to my colleagues, especially to my old colleague Ed Towns, it is an honor to be here. This postal reform issue has been one that has been with us for a while, as you know, and I hope that we can do work that is as good as that done by Ted Stevens almost 3½ decades ago.

In fact, he did his work just shortly after I was here as a Navy ROTC midshipman, and we want to be able to build on good work that has been done by Congressman McHugh and those who helped him shape his legislation.

As my colleagues are aware, this will likely be the final hearing I think we are going to hold following the declarations from the President's Postal Commission. I think it is a good sign that we are here, Democrats and Republicans, House and Senate, united in the belief that we need to make some fundamental changes to the way our Postal Service does business in the 21st century.

By all accounts the Postal Service has been a success since it was created. I think even its detractors would admit that. It receives virtually no taxpayer support, and it services hundreds of thousands of employees, to provide to nearly every American, nearly every day, that service is second to none.

And more than 30 years after its birth, the Postal Service is a key part of our Nation's economy, delivering to more than 100 million addresses and supporting a massive mailing industry. And

even a casual observer, however, can see that the past few years haven't been easy ones for the Postal Service.

As we learned in our hearings in Governmental Affairs on the other side of the Capitol, they have been difficult for private firms, large and small, and for millions of mailing industry employees who depend on stable postal rates. I am pleased that we have this once in a generation opportunity, maybe once in a two generation opportunity now to work in a bipartisan way to modernize the Postal Service, to update its business model for the 21st century.

At the end of last year, as we all know, President Bush issued a set of postal reform principles focused on those recommendations from his Postal Commission aimed at improving transparency and accountability at the Postal Service and giving management the increased flexibility that they need to streamline operations and seek out new mail volumes.

And his principles touch on the main themes addressed in S. 1285 and in Congressman McHugh's latest bill. I think it is safe to say, my friends, that as I have said before, that we probably have agreement on 90 percent of what ought to be in the new postal reform bill.

And now that our hearing work is just about complete, I look forward to sitting down with you, Madam Chairwoman, with our friends here in the House, Congressman McHugh, and our other interested colleagues to put together a bill that is a worthy successor to that hammered out 40 years ago by a junior Senator, Ted Stevens. Thank you.

Chairman TOM DAVIS. Thank you, Senator. Mr. Clay.

Mr. CLAY. Thank you for allowing me to claim my time. I appreciate that. It is an honor to participate in today's hearing on developing principles for meaningful postal reform with our Senate colleagues. I would also like to extend thanks to today's witnesses. This historic meeting leaves no uncertainty about the willingness of Congress to address the important issue of postal reform.

Postal reform has presented us with a unique opportunity to craft legislation that would modernize our postal system to become more customer friendly and efficient in the 21st century. Still, there are many components of postal reform that have yet to be resolved, such as the Civil Service Retirement System, military obligation, and the fair and equitable treatment of postal workers, to name a few.

The U.S. Postal Service is no ordinary business enterprise. It is a government entity with no shareholders that provides a commercial service which operates under a break-even mandate and pays no Federal, State or local taxes. It is truly unique.

Fundamental reform is sorely needed to bring the service into the information age. We must examine further efforts to cut costs while maintaining service and preserving universal delivery. I trust that as a body we will take the time to resolve our differences on the issue of postal reform. Simply put, we owe that commitment to both the ratepayers and taxpayers.

And, Mr. Chairman, I look forward to hearing from today's witnesses, and ask unanimous consent to enter my statement in to the record.

[The prepared statement of Hon. Wm. Lacy Clay follows:]

Statement
of the
Honorable Wm. Lacy Clay
Before the
Joint Hearing Senate-House Governmental Affairs / Reform Committees
Tuesday, March 23, 2004

"The Postal Service Crisis: A Joint Senate-House Hearing on Principles for Meaningful Reform"

Mr. Chairman, it is an honor to participate in today's hearing on developing principles for meaningful postal reform with our Senate colleagues. I would also like to extend my thanks to today's witnesses. This historic meeting leaves no uncertainty about the willingness of Congress to address the important issue of postal reform.

Postal reform has presented us with a unique opportunity to craft legislation that would modernize our postal system to become more customer friendly, and efficient in the twenty-first century. Still, there are many components of postal reform that have yet to be resolved such as the civil service retirement system military obligation, and the fair and equitable treatment of postal workers to name a few.

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Mr. Chairman I look forward to hearing from today's witnesses and ask unanimous consent to enter my statement in the record.

Chairman TOM DAVIS. Without objection, so ordered. Any other Members wish to make opening statements at this point? Again we have—I am sorry, Mr. Towns.

Mr. TOWNS. Mr. Chairman, let me thank you for holding this joint hearing today on the very important issue of postal reform. This has been a thorough and informative process, and I feel confident that both sides are well prepared to fashion a bill that will put the Postal Service on firm ground for years to come.

The Postal Service is truly at a precipitous point, as it is quickly heading down a path which is economically unsustainable. Each year the Postal Service adds nearly 2 million new homes, businesses or other new delivery points. However, at the same time, mail volume has been declining for 3 straight years. While some of that decrease is due to the recent economic recession, a significant portion of the decline is due to structural changes that are only going to become more pronounced.

Overall, the Postal Service has lost $2.3 billion, that is B as in "boy" in the last 3 years. We have bought some time by passing the Civil Service Retirement System Funding Act. We saved more than $6 billion for the last 2 years. But we cannot allow this breathing room to deter us from making important but tough decisions. Our constituents are depending on us as well as the Postal Service and the mailing industry.

Together this enterprise comprises a nearly $900 billion industry, employing 9 million workers nationwide, and representing more than 8 percent of the gross domestic product. So a failure to act will have wide ranging consequences.

As I have said before, there is significant room for agreement on a vast majority of issues, such as the escrow account and the military pension issues. In areas of limited disagreement, I strongly believe that a compromise can be forged that increases the efficiency and effectiveness of the Postal Service, accommodates the needs of the mailing industry, and at the same time protects our postal workers.

I look forward to hearing from our witnesses today about their views on what principles should guide our committees in writing a final postal reform bill.

Thank you very much, Mr. Chairman, and I yield back the balance of my time, and I am glad to see that Senator Carper made his way over. It shows you that this is an important issue.

Chairman TOM DAVIS. Thank you very much. Members will have 7 legislative days to put statements in. We will proceed to the panel now. And I think, Mr. Fineman, we will start with you, and then, Mr. Potter, to you. Mr. Roseboro, do you want to make any remarks or are you just here to be the flycatcher for the Secretary?

Mr. ROSEBORO. It is a privilege to have the best job in the world right now, sir. I will report back.

Chairman TOM DAVIS. Go ahead.

STATEMENT OF DAVID FINEMAN, CHAIRMAN, BOARD OF GOVERNORS, U.S. POSTAL SERVICE

Mr. FINEMAN. Thank you, Chairman Davis. As most of you know, I am the chairman of the Board of Governors of the U.S. Postal Service, and I have served a sentence with Congressman McHugh.

For the last 8 or 9 years we have been together. My term expires on December 8th of this year. And this will, as I said to Congressman McHugh a little bit earlier, probably be the last time that I have an opportunity to testify before the committee, because I look forward to this committee going into the hard work to get a bill out and probably won't need too much more testimony.

I want to take this opportunity just to thank Congressman Davis, Senator Collins, Senator Carper, Congressman Danny Davis also, and the people who have worked so hard on this legislation.

Congressman McHugh and I were lonely voices, I think, about 8 years ago or so saying that we thought that there was going to be a problem. And the last time I testified, Senator Carper, I said that you and I both take the train. As you know, I come from Philadelphia. We both take that train coming in on that Northeast extension.

And the last time I said that there was a train wreck about ready to happen. I thought that the train was probably in Baltimore and coming down to Union Station. And I guess it might be at BWI now as it keeps going down. It is not ready to come into Union Station, but it is pretty close.

As I listened to Secretary Snow's remarks, I thought back upon the 8 years or so that I have been on the board. And I think the remarks about the pension and the funding of it reflect what is such a tough job here, understanding what the Board does.

You know, at one point the legislation that you presently have says that, well, we have to run this like a business. And we do try our hardest to run this like a large business would be run. Many of us have sat on public boards before.

But at the same time, you take an issue like the pension. I think it is just a good example. Other businesses, you know, you don't fund what are your military obligations by the business itself. It just doesn't work that way. You want us to act like a business and be independent; at the same time you say we have certain obligations. We understand the obligation of universal service.

But at the same time, if we are going to be self-sustaining, we should be really self-sustaining. I am a lawyer by trade. The $3 billion was put into an escrow fund. That means, the way I practice law, that it is sitting there just waiting for something to happen. That something was that Congress wanted a report from us as to how we were going to use that money. We gave that report.

Chairman Davis reported back to us, at least today, that they were satisfied with what the report was that we gave. It seems to me that the escrow then gets broken, similar to the way you do a real estate deal. You put some money in escrow, the escrow gets broken, and it goes to one of the parties. This is no different. You asked us for something. We set it aside. It is obvious to us, and obvious I think to this panel, that money should be given to us.

And while we talk about the escrow fund, we are coming to a point in time where Congressman McHugh, the main issue that he and I spoke about for the last 8 years was the ratemaking process. And the ratemaking process is broken. It doesn't work. I am a lawyer. And I was interested in 1965—I graduated from George Washington Law School in 1970, the same year that this act came into existence.

I kind of wish I knew about it. I have called it the Lawyers Welfare Act of 1970. You know, to a large degree that is what happens. It churns litigation. It churns the ability to set rates. And there is another process that can happen, you have all heard me talk about it before. And you have all had proposals, and I think it will happen.

But you take this and the escrow fund, look at the position we are in today. As the chairman of the Board, I have a fiduciary obligation to the American public, to the Postal Service, to the ratepayers. We are going to have to act on rates probably sometime in November. If we don't know whether or not this $3 billion is coming back into our coffers, we are going to have to do something.

I mean, it is not a threat, it is not a promise, it is just reality. It is just the way the system works. The system shouldn't work this way. There should be another rate making process. And I would hope that you would attack it.

Last thing I would like to comment upon, and I think I have the right to do it as the chairman of the Board, is about governance issues. I do want to thank the President for putting together this Presidential Commission and the people over at Treasury who worked so hard on that within a short period of time. I was amazed that they could come out with their report within the short period of time that they worked. However, the one issue where I do disagree with the President's Commission deals with governance issues. And the reason that I disagree is the manner in which the directors are chosen, and as Congressman McHugh knows, I couldn't care less whether you call us Governors, directors or whatever. The manner in which they are chosen could cause a partisan board to come into existence under the formula selected by the Presidential Commission. My experience has been that these are not Democratic nor Republican issues. It is reflected in the bipartisan nature of whom I am testifying before today. It is reflected in the bipartisan nature of our Board.

Congressman Carper is a good friend of a Republican, Bob Rider from Delaware, the former chairman of this Board, and he and I were confirmed on the same day. There are no issues between us that are Republican and Democrat, and I would hate to see this Board formulated in a manner in which there could be either a Republican board or a Democratic board depending on who the President is, and I ask you very much to give that a little bit of your attention.

And with that, I know that we—there are many of you here today, and many of you might have questions. So I want to cut my remarks short. And thank you again, thank Chairman Davis and the two Senators, for calling this meeting. You know, as a kid from Philadelphia in a row house, I kind of pinch myself a little bit that I am in some ways helping to make history. So, Mr. Chairman, thank you very much.

[The prepared statement of Mr. Fineman follows:]

STATEMENT OF DAVID FINEMAN, CHAIRMAN
UNITED STATES POSTAL SERVICE BOARD OF GOVERNORS
AT THE JOINT HEARING OF
THE HOUSE COMMITTEE ON GOVERNMENT REFORM AND
THE SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS
MARCH 23, 2004

Good afternoon, Chairman Collins, Chairman Davis, and Members of the House and Senate Committees.

I appreciate the interest of both the House and Senate in assuring the continuance of affordable universal mail service for everyone in America. Thank you for the opportunity to talk with you about the critical and very timely issue of comprehensive legislative reform for the United States Postal Service.

As you know, the Postal Service Board of Governors directs the exercise of the power of the Postal Service. We establish strategic policies, basic objectives, and long-range goals for the Postal Service. We take these responsibilities very seriously, and understand the implications of our efforts for the American people and economy.

I have had the pleasure of being a member of the Board of Governors of the United States Postal Service since 1995. Over the course of those nine years, I have worked closely with my fellow governors to conscientiously carry out our legal mandate to "direct and control the expenditures and review the practices and policies of the Postal Service".

I also came to realize early on that the law under which we operate is both antiquated and inefficient. As a result, I have had the pleasure of getting to know many of you and your staff as I have worked with you towards bringing about change to this law.

I have also come to appreciate the value of mail service to the American people and the role it plays in making the US economy one of the strongest and most vibrant in the world. And, I am proud of the thousands of dedicated Postal employees who get the mail delivered regardless of the obstacles faced.

We have faced some significant challenges in the last few years, and I want to thank both Houses of Congress, the General Accounting Office, and the Administration for their assistance in helping us address them. In particular, I would like to thank each and every member of these two Committees for your attention to our concerns and continued efforts on our behalf.

By any measure, 2003 was a very good year. The United States Postal Service set records in service, productivity and customer and employee satisfaction, while also maintaining universal mail service and generating a positive bottom line for the business.

We closed the year with a net income of $3.9 billion, reflecting both our success in managing costs and improving efficiency and the positive effects of the Civil Service Retirement System funding reform legislation.

Once the Office of Personnel Management discovered that, without a change in our payment schedule, the Postal Service would overpay its obligation to the Civil Service Retirement System by $105 billion, it was thanks to the quick action by Congress and the Administration that we avoided this overpayment.

The savings available through the new law helped us reduce outstanding debt by more than one third, from $11.1 billion to $7.3 billion, and make it possible for us to continue reducing debt this year and holding postage rates steady until at least 2006.

But these short-term successes are masking a basic flaw in the business model upon which the Postal Service was founded – that is the assumption that growth in mail volume will provide sufficient revenues to meet the cost of providing universal service to an ever-growing number of delivery points.

That assumption was valid when the law creating the modern Postal Service was written three decades ago, but today, the Postal Service faces a major structural change in the way Americans conduct business. Electronic alternatives to hard copy mail are becoming increasingly acceptable to the public and will continue to divert significant portions of the mail stream away from the Postal Service and onto the Internet.

Significant amounts of business correspondence have been diverted from the mail stream, and the bills, payments and other financial transactions that constitute the bulk of First-Class Mail volume remain vulnerable to further diversion.

First-Class Mail volume declined for two years in a row. From a peak of 104 billion pieces in 2001, First-Class Mail declined by 1 billion pieces in 2002 and another 3 billion pieces in 2003. While this decline is partially attributable to sluggish economic growth and perhaps the lingering effects of the bioterrorist attacks of 2001, electronic diversion is a factor as well.

For the first time since the Postal Service was reorganized 34 years ago, First-Class Mail volume was less than 50 percent of total mail volume in 2003. Total mail volume was 202 billion pieces, with First-Class Mail registering only 99 billion pieces.

Standard Mail, which is largely advertising, reached its highest share of the total ever in 2003, at 45 percent. While the prospects of growth in advertising mail volume are good, the contribution margin obtainable from this very price-sensitive category is much lower than that for First-Class Mail. It takes about three new pieces of Standard Mail to make up for the loss of one piece of First-Class Mail.

The financial problems presented by declining volume and changes in the mail mix are exacerbated by the need to serve an expanding delivery network. Although the total amount of mail we delivered declined between 2002 and 2003, the number of addresses served increased by 1.9 million. While we deliver to 5.4 million more addresses than in 2000, the amount of mail we delivered has declined by 5.7 billion pieces since that time.

Remember, our business model was designed around the premise that increasing volume will pay for an ever-expanding delivery network.

As a result, we are challenged to find new expense reductions and revenue growth to compensate for the decline in this historic funding source.

But the decline in First-Class Mail volume took away $642 million in revenue contribution last year alone. This is the same as adding an extra one percent to our cost base.

Essentially, the volume of First-Class Mail and the number of delivery points are moving in opposite directions. Since 2001, while First-Class Mail volume decreased, our delivery network has expanded by 3.7 million new delivery points. We absorbed these deliveries through productivity increases rather than hiring the equivalent of 4,000 new carriers each year, purchasing new vehicles, and adding facilities space.

We expect this delivery point growth to continue for the indefinite future. The Bureau of the Census reported housing starts in August 2003 at a seasonally adjusted rate of 1.82 million, while Harvard University's Joint Center for Housing Studies reported that housing production in the current decade is expected to "exceed the 16.6 million units built and manufactured between 1991 and 2000" due to "increasing household growth, strong demand for second homes and better balance in rental markets."

Additionally, strong immigration, younger members of the baby-bust generation living on their own, aging baby-boomers purchasing second homes and shifts in family composition contribute to a projected average annual demand for 1.8 million new housing units.

There is another issue as well. It is very labor intensive to deliver the mail. And salaries and benefits are our biggest expense. This expense is determined by the number of employees, the number of hours they work, their rates of pay and the benefits they receive, such as health and retirement benefits.

Our expenses are also affected by increases in the premiums for the health plans of our retired employees. A significant source of expense growth in recent years has been the inflation in health benefits. Federal Employee Health Benefit Program premiums increased 13.3 percent in January 2002 and by 11.1 percent in January 2003.

Premium increases in January 2004 averaged 10.6 percent. This has translated to health benefit cost increases for the Postal Service of $471 million in 2002 and another $471 million in 2003.

Each one of these issues presents challenges to us, given the limitations of our current mandate. Combined, they offer a daunting prospect for the viability of our business model.

Nonetheless, the Board of Governors has the legal obligation to manage within the constraints of the current business model, so that is what we have been doing – and in my opinion, doing quite well.

But, each year, as we aggressively pursue additional improvements, the margin of return becomes smaller as efficiency increases. Essentially, the more we improve our efficiency, the less room there is to make up for the gap caused by the fixed costs inherent in our current business model.

We must find new ways to give postal management the modern business tools it requires to keep the Postal Service viable in the 21st century. We must be freed from the legislative shackles of three decades ago.

We have been advocating this position for some time now. I have personally worked with many members of Congress as legislation was developed to address these issues.

In fact, in March of 2001, the Board of Governors sent a letter to Congress and the President specifically addressing the need for significant statutory reform in pricing and labor flexibility. In the letter we stated that: "We see alarming trends that seriously threaten the future of America's mail service... Without change to our regulatory framework, universal service will be difficult to maintain. We foresee rapidly rising rates and reduced service if legislative reform is not enacted promptly..."

That is why we were so pleased by the creation of the President's Commission on the United States Postal Service. During the eight months that the nine-member bipartisan commission held public meetings and met with stakeholders, we provided the Commission with a great deal of information and documentation about our organization's needs and concerns. The Postmaster General and I testified before the Commission. Other Postal Service leaders testified in detail about their areas of expertise as well.

The Commission presented its findings in July. It offered recommendations for change in several key areas: the Postal Service business model, private-sector partnerships, technology and workforce. In December, the President publicly urged Congress to enact postal reform legislation based on five principles that were in the Commission's report.

We agree with the goals of these five principles – Best Practices, Transparency, Flexibility, Accountability, and Self-Financing. In many ways, they mirror our Transformation Plan for the Postal Service, which is our blueprint for the future.

As part of its recommendations, the Commission proposed changes in our ratemaking process. From previous testimony, you know that the Board of Governors is on record in favor of reform of the current ratemaking structure.

The current system is cumbersome and expensive, and it pits the entire postal community against one another in a litigious free-for-all. In its place, we would support a system including a well-constructed price cap model that properly addresses the Postal Service's economic situation.

To protect service, the new model must include an opportunity for the Postal Service to go back to the regulator for special relief in exigent circumstances.

The Board is determined to do everything we can to hold future prices within reason, for the benefit of our customers and out of necessity for the long-term health of the institution.

None of us has a crystal ball, however, and experience has reminded us of the power of intervening events to overturn the best of plans and projections.

This necessarily means that the Postal Service must have more control over the benefits dimension of its cost structure. Over the last five years, hourly wage expense has increased by an average 3.2 percent per year.

At the same time, the cost of employee health benefits has increased 11.0 percent. Retiree health benefits cost has grown by 15.6 percent. Workers' compensation expense has increased by 10.9 percent. All of these costs are out of the control of the Postal Service.

In a period of declining First-Class Mail volume and revenue contribution, the Postal Service cannot hope to keep total costs within inflation in the face of double-digit increases in the cost of benefit programs which it does not manage or control.

All of my adult life, I have been a strong believer in, and an advocate for, collective bargaining. I am opposed to the suggestion that a postal regulator should have any role in setting postal wages or wage standards.

By the same token, I believe that for collective bargaining to be effective, everything should be on the table, including benefit programs.

And speaking of benefits, we are on the record as recommending that the obligation to fund the military service costs of postal employees' Civil Service Retirement System retirement benefits return to the Department of the Treasury.

And we have also recommended that the escrow provisions of the Act be eliminated and that the "savings" be used to fund retiree health care benefits, retire debt or fund capital expenditures. Both of these issues could have a profound effect on our ability to manage to the bottom line in the years ahead.

And the escrow provision illustrates the problem with the entire ratemaking process. As the ratemaking process now stands, the Board of Governors, as part of our fiduciary responsibility, will very soon have to begin the ratemaking cycle for 2006 with the assumption that we will have to cover the costs incurred by the escrow account.

All of us wish to see the escrow requirement repealed, and I am confident that you and your colleagues will do so. But until the law is changed, we must begin the planning process based on the assumption that the requirement will remain on the books. And we must plan for a rate increase much larger than we would like, or hopefully is necessary.

You can see how little flexibility we have to address real-time financial changes, given the time frame we must operate under with regard to setting rates. I can think of no better illustration of the need to change the process.

The Commission also recommended significant changes to our governing board. I cannot agree with their recommendations in this area, and I want to tell you why.

Today, the Governors are appointed by the President with the advice and consent of the Senate. We serve staggered nine year terms, and by law, no more than five members may belong to same political party.

This structure has allowed the Postal Service to enjoy bipartisan oversight and consistent governance of this $68 billion national service provider. We are concerned that the Commission's proposal for a new Board of Directors could change this.

Under the Commission's recommendations, the President would appoint three Board members, who would then select the first eight independent Board members, with the concurrence of the Secretary of the Treasury. After that, independent members would be selected by the Board as a whole, again with the concurrence of Secretary of the Treasury. But there would be no limits on the political affiliation of Board members. In addition, the proposal allows the President or the Secretary of the Treasury to remove directors.

My concern is that if enacted as proposed the Senate's statutory role of "advice and consent" would be greatly diminished. The lack of party affiliation requirements and the ability of the President and Secretary of the Treasury to unilaterally remove members of the Board creates a perception of undue influence and could potentially result in highly-partisan Boards in the future.

Rather than becoming more impartial and businesslike, a Board of Directors as envisioned by the Commission could be less impartial, less knowledgeable, and possibly more political. None of these possibilities are in the best interest of the organization, the American people or the U.S. economy.

We fully understand that with the increased level of management flexibility that we are requesting must come an appropriate level of oversight. This provides a necessary balance to protect the public interest.

But the Commission proposed that this oversight be largely provided by a new Postal Regulatory Board, with discretionary policy authority in a wide range of areas, to replace the current Postal Rate Commission, which has a more limited mandate.

We understand the rationale for the discretion the President's Commission has defined for the Postal Regulatory Board. Yet regulators are normally required to operate within limits and guidelines. Regulated private companies and their shareholders have legal protections against arbitrary action by the regulator that the Postal Service cannot have as a government institution.

At the least, there should be standards drawing a clear line between what is appropriately a managerial function within the oversight of the Governors or Directors, what is a regulatory function committed to the regulator, and what is a public policy function reserved to the nation's lawmakers.

For instance, the Postal Regulatory Board can revisit the vital national issues of the postal monopoly and universal service. From the perspective of the Postal Service Board of Governors, these are clearly issues of broad public policy that should be resolved as part of our management responsibilities, as determined by Congress.

They are not regulatory issues. Without defined limits or guidelines, the regulator could conceivably limit the monopoly in such a way as to jeopardize universal service or even redefine the scope of the nation's mail service itself.

The powers of the proposed Postal Regulatory Board could also affect the outcome of the collective-bargaining process. The Postal Service has been, and continues to be, a strong supporter of collective bargaining. This process of give and take assures that the interests of our employees – and the unions that represent them – are considered within the larger picture of the Postal Service's financial situation and the needs of our customers.

But by determining the range within which wages may be negotiated, the Postal Regulatory Board could impede the ability of the parties to successfully negotiate agreements.

The President's Commission also said the Postal Service should set the standard for financial transparency by which all other Federal entities are judged. We agree.

In fact, last August, at the Board's direction, the Postal Service began to enhance the transparency of its financial reporting. Our 2003 Annual Report, which was issued in December and is posted on our web site, includes enhanced disclosure in the footnotes and the Management Discussion and Analysis section. In addition, in the first quarter of Fiscal Year 2004, the Postal Service began to publicly report, on its web site, significant events in accordance with SEC Form 8-K reporting requirements.

We achieved greater financial transparency in February with the issuance of our Quarter 1, Fiscal Year 2004 Financial Report. Consistent with SEC Form 10-Q, this report will include an enhanced Management Discussion and Analysis section and expanded financial statements.

And, earlier this year, I, along with other members of the Board of Governors and senior Postal Service officers, discussed the topic of annual disclosure as they are reported through SEC Form 10-K. In the coming months, we will complete plans to further enhance our annual financial reporting.

Despite the constraints we face, under the guidance of the Board of Governors, today's Postal Service is managing for results. We have asked management to focus on three key strategies as part of that effort: improving operational efficiency, adding value for our customers, and enhancing our performance-based culture.

With the help of management, Congress, and stakeholders, we identified each of these strategies in the Transformation Plan we developed in 2002. We know the Postal Service must continue to change to meet the needs of a changing nation. The Transformation Plan is helping us do that.

Regardless of the long-term proposals out there right now, our Transformation Plan remains our guide to doing all we can within the current law to increase the value of the mail, make it more effective than ever and assure its future.

We have taken other steps to take full advantage of all the flexibility granted to us by current law. Let me give you some examples.

First, let's touch on our fiduciary responsibilities. We have an Audit and Finance Committee to review the soundness of accounting and internal control practices and major financial statement accruals for the organization. The Committee also monitors financial performance, debt levels and cash management.

So, in February of 2001, when the Chairman of the Board's Audit and Finance Committee reported that the trends in Postal Service finances were "alarming and unacceptable...", we quickly moved to re-examine how this organization was conducting business on all levels.

Management was directed to temporarily freeze all new facility commitments, reduce planned new facility commitments for the year by $1 billion, and limit future capital commitments to levels that could be funded from cash flow.

In the last three years capital commitments have been limited to those projects that have an acceptable return on investment, are required by law, or have been necessary to insure customer and employee safety. New commitments, which had averaged $3.5 billion per year in the five years leading up the temporary freeze, have averaged $1.6 billion per year in the three years since.

These measures have worked. Cash flow has been adequate to fund capital spending in the last three years and debt has fallen.

The most important way in which the Board provides direction to the Postal Service is through the selection of the Postmaster General. In selecting Jack Potter, a career operations veteran to lead the organization, the Board sent a clear signal that service performance, cost control and productivity improvement were the priorities.

The organization responded. Service performance scores climbed to record levels and the number of our career employees declined by 24,000 in 2003. We plan an additional reduction of 25 million work hours in 2004, which translates to as many as 11,000 fewer career positions.

Best of all, we have reduced these positions through attrition, voluntary retirements, vacancies and reassignments. No employees were laid off.

The Board also decided that management should give greater emphasis to focusing on its core strengths. One area of particular concern was e-commerce. We began a re-evaluation of all e-commerce business plans.

After reviewing the financial performance and expectations for these plans, as well as their alignment with the Postal Service's core business, all but one of our e-commerce ventures were discontinued or realigned.

At the time we began our review in February 2001, e-commerce spending was $33 million annually, producing gross revenue of only about $2 million. Today, the Postal Service is spending less than one million dollars a year on e-commerce.

The lesson is clear. We don't have the luxury of taking our eye off the ball. We must remain focused on our core business. This remains a priority for the Board in all its strategic policy and fiduciary decision-making.

The Board's focus on the bottom line has strengthened financial management within the Postal Service. The spread between long-term and short-term interest rates last year created an opportunity to refinance our debt, reducing our average interest rate from 5.1 percent to 1.1 percent.

As a result, we saved $62 million in interest in 2003. And, we expect to save an additional $336 million in 2004.

We are also enhancing existing products and services – and expanding access and convenience to postal services. Our popular website, USPS.com, is a great example of this, offering access to information, stamps and one of our most successful new offerings, Click-N-Ship.

With Click-N-Ship, customers can create and print mailing labels from their home computer — with or without postage — and carriers will pick the packages up at the customer's home.

We will be rolling out self-service kiosks called Automated Postal Centers this year as well. These kiosks will let customers buy stamps and postal products just as ATMs enable customers to conduct self-service banking. The goal of these efforts is to promote ease-of-use for our customers. The easier we make it for them to use our services, the more of our services they are likely to use.

There is another area where the Board has asked management to take a long, hard look at current practices – the vast network of facilities and transportation infrastructure that has developed over the years.

The opportunity to consolidate operations and streamline our network represents a significant cost reduction opportunity. A leaner plant network would drive transportation and facility costs down. That benefits everyone.

Along the same lines, the Postal Service must be allowed room to implement infrastructure changes including – but not limited to – changes in the number and location of post offices and processing plants, and changes in our transportation networks. That simply makes good business sense.

In this instance and the others I have mentioned, the Board provided leadership and support to an able top management who effectively addressed a number of difficult problems. We are fortunate to have the management team we do as we face the challenges ahead of us.

But let's be clear about this. The combination of declining First-Class Mail volume, increasing delivery points, and expanding benefits costs has put the Postal Service into a box which no amount of good management, cost cutting, or improved efficiency can get us out of. We can't get out of the box because the current business model won't allow us to.

Once again we need your help.

The time is now to provide the Board of Governors and postal management with new tools to meet the new business environment it faces. We cannot wait until the Postal Service is in such financial crisis that drastic service or delivery reductions are our only option.

The Governors of the Postal Service need additional flexibility in directing the activities of the Postal Service. The Postal Service's ability to adjust its retail network is far too constrained by current law. We have a burdensome rates process. We are being asked to operate in a very competitive and changeable marketplace without the ability to negotiate prices and service with our major customers.

We cannot be asked to conduct ourselves in a businesslike manner when the tools to do so are not available to those running the business. To quote one of Philadelphia's favorite sons and the first Postmaster General of the United States: "You will find the key to success under the alarm clock..." Today, the alarm clock is ringing loud and clear.

In closing, let me say that the Board of Governors will continue to do everything possible to protect the basic right of affordable, universal mail service for everyone in America. We will assure that all positive actions within the current law will be taken to make the Postal Service more efficient and customer responsive.

Yet we must face the simple fact that our business model — established by the 1970 Postal Reorganization Act — is no longer valid. We can no longer expect that the costs of serving a continually expanding delivery base will be offset by increasing revenue from continued mail volume growth.

This is my last year of service on the Board, so I have some perspective on the process. I intend to continue working with the entire mailing community on these critical issues. And I know the Board of Governors will continue to direct the organization with the full range of tools available to us under current law.

As the Board has demonstrated over the last few challenging years, the current management and governance system works. The fact that we are having this conversation in anything other than a crisis mode confirms it.

But we are reaching the limits of the current opportunities available to us. Sooner or later, the status quo is going to have drastic consequences for the Postal Service and the entire mailing industry. If prices are forced to rise too rapidly, mail volume will only fall even faster. Service could be affected as well.

We must change the basic assumptions about the business of delivering the mail in America, and we must do it while we have the window of opportunity that our current financial good news affords us.

The alarm clock is ringing. The time is now to provide us with the new tools to allow us to manage this $68 billion service the right way, like a business, with our eye on the bottom line.

The Governors of the United States Postal Service will continue to do everything in our power to assure that the Postal Service of the 21st century will continue providing affordable, universal mail service for all customers and all communities in America. We need your assistance to make that happen, now and for the future.

Thank you, Chairman Collins, Chairman Davis, and Members of the House and Senate Committees. I would be happy to answer any questions you may have.

# # # #

Chairman TOM DAVIS. Thank you. Thank you, General Potter, thanks for being with us.

STATEMENT OF JOHN E. POTTER, POSTMASTER GENERAL OF THE UNITED STATES, U.S. POSTAL SERVICE

Mr. POTTER. Good afternoon, Chairman Davis, Chairman Collins and members of the committee. I am pleased to come before you today as we continue to discuss the critical need for comprehensive reform of the legislative framework governing the Postal Service.

I am especially grateful to Chairman Collins and Chairman Davis for your active leadership on postal legislative reform and for providing the opportunity for all stakeholders in the mailing community to voice their needs, preferences, and common commitment to postal reform. And while I am at it, I want to thank everyone on the committee. A lot of accolades have already been said, I want to echo them.

Let me begin by saying first of all how proud I am of postal employees. All of the men and women who work for the Postal Service, they are doing a great job, and I am very proud of what they are doing. We have seen service performance rise to record levels. Customer satisfaction is at an all time high.

We have had an unprecedented 4 straight years of productivity improvement. Our employees are delivering for America. And speaking of delivering for America, the Postal Service is most grateful to the administration and Congress for the Civil Service retirement legislation passed last year. The legislation enabled us to reduce our outstanding debt by one-third and will help us hold rates stable until 2006. That legislation left two open issues to be addressed this year; namely, the obligation for military benefits and the escrow.

As we have previously testified, the Postal Service believes it should not be responsible for funding Civil Service Retirement benefits earned by postal employees while they served in the military. This $27 billion obligation includes a $7 billion reimbursement to the Treasury for payments made to retirees since 1971, as well as $10 billion interest on those payments.

There is also an additional $10 billion in cost to cover future benefits for existing employees' military service. We disagree with the shift in the obligation from the taxpayer to the ratepayer. The legislation also requires the Postal Service to create an escrow account from savings resulting from the legislation.

The simple fact is that under present postage rates there will be no funds available after 2005 to place in an escrow account. The moneys needed for the escrow fund equate to a 5.4 percent rate increase. I don't believe a rate increase is good for the recovering economy or for the mailing industry or for the long-term future of universal service as we know it today. Therefore, I strongly urge the elimination of the escrow requirement.

Let me now turn to key priorities we believe should be addressed in your deliberations on postal legislation. First and foremost, we believe that we must have the flexibility to adjust rates to meet the varying demands of customers. Mailers have long told us that small annual price increases are preferred to price shock every cou-

ple of years. Annual increases could be more easily absorbed in their business plans.

Conversely, the public prefers a uniform rate for a single piece of first class mail that would change less frequently. The current ratemaking system does not allow us to accommodate those varying preferences. We recommend that a model that gives the Governors of the Postal Service the authority to set prices with an after the fact review process that addresses issues such as cost coverage, consumer interest, and impact on competition would be beneficial.

In a related area of price caps, my concern is that given the volatility of today's marketplace an imperfectly crafted price cap could be harmful. To guard against that concern, we propose that the price cap be constructed to recognize the many cost factors which enter into the ratemaking process, many of which are beyond our control.

Specifically, we propose that in addition to a metric for wage growth, a realistic price cap would also account for delivering network expansion, fuel price volatility and, most importantly, legislatively mandated employee benefits.

Second, it is essential that we have flexibility to adjust our national infrastructure—our retail and processing networks—to meet changing customer preferences and market conditions. Many postal retail services are now conveniently available on line, in grocery stores and in other private sector retail outlets and through the mail. We should not be expected to retain all of our post offices simply because they have always been there.

Likewise, sorting capability continues to be increasingly more efficient. This, combined with the potential loss of mail volume, requires an evolving processing network to minimize costs.

Third, it is essential that the Postal Service be given greater latitude to manage and control costs. Despite our success in reducing costs over the past 4 years, the fact remains that a significant portion of our costs are imposed on us by legislation. For us to succeed, those costs must be addressed.

For example, Federal statute gives the Department of Transportation authority to set the rate we pay airlines for international mail transportation. International mail is a highly competitive area. We should be able to negotiate directly with airlines in the same way we do in contracting for domestic air transportation costs. It is more businesslike and provides us an opportunity to reduce costs which ultimately benefit the marketplace.

When you will look at postal expenses as a whole, employee benefits are the single largest cost category that today is beyond our control. Benefits, such as retirement contributions, health benefits, life insurance, retiree health benefits and workers compensation are mandated by statute.

Collectively last year they amounted to more than $13 billion in costs. We propose that a collective bargaining process which covers almost 90 percent of our career work force be expanded to include the negotiation of benefits in addition to wages, hours and conditions of employment. In short, everything should be on the table.

Finally, I would like to comment on a statement to the Committee on Governmental Affairs earlier this month by UPS Chairman and CEO Mike Eskew. "The Postal Service's mail monopoly allows

it to subsidize competitive products and inappropriately compete with the private sector." His statement misses the mark on both counts.

First, the Postal Service's monopoly on letter mail does not subsidize competitive products. Cross-subsidization is against the law, and in a nation of laws we are not in the business of breaking the law.

Second, a principal duty of the independent Postal Rate Commission is to ensure that cross-subsidization doesn't occur. During our arduous ratemaking process, if there were cross-subsidization, one or more of the rate intervenors would point that out to the PRC.

I would add that in 2003 our competitive products, Express Mail, Priority Mail and package services, earned $2.5 billion over and above their direct costs. The funds were made from Express Mail, Priority Mail and package services and they were used to finance universal service. Terms like inappropriate competition are easy to toss around, but they often ignore an important lesson of history.

At the turn of the century by law the Postal Service, the Post Office Department at the time, could not carry parcels weighing more than 4 pounds. Only private express companies delivered larger packages. But then more than half of the American public lived in rural areas and received little or no parcel delivery from private carriers. Those who did had to pay exorbitant rates for their service.

When the Parcel Post Act of 1912 was enacted, all of that changed. For the first time in history all Americans, from those living in major urban centers to residents in remote rural areas, were able to use the mail to receive the goods they needed at affordable prices. Today the Postal Service continues to deliver to every address in the country without residential or rural surcharges that are increasingly common by other companies.

In fact, recently the elected public officials of Pasco, WA protested such surcharges of $1 for business delivery and $1.75 for residential delivery.

Pasco has a metropolitan area of more than 150,000 people. The lesson is clear. We have an opportunity and obligation to preserve and protect universal mail service in this country, the right and privilege of every American to receive reliable, efficient, affordable mail service, regardless of where they live or do business.

I believe that this is the legacy we must preserve for our future generations, a legacy that will be preserved only if we have the courage, determination and vision to enact legislation that will truly help us build a stronger Postal Service in the future.

Thank you, Chairman Collins, thank you, Chairman Davis, and the rest of the committees for your interest in the Postal Service.

[The prepared statement of Mr. Potter follows:]

TESTIMONY OF
JOHN E. POTTER, POSTMASTER GENERAL/CEO,
BEFORE A JOINT HEARING OF THE
COMMITTEE ON GOVERNMENT REFORM,
UNITED STATES HOUSE OF REPRESENTATIVES,
AND THE
COMMITTEE ON GOVERNMENTAL AFFAIRS,
UNITED STATES SENATE

MARCH 23, 2004

Good afternoon, Chairman Davis, Chairman Collins and Committee members. I am pleased to be with you today as we continue the critical discussion about the need for comprehensive reform of the legislative framework governing the Postal Service.

In the months since the President's Commission on the United States Postal Service issued its final report endorsing the very real need for postal legislative reform, virtually every stakeholder has taken an active part in this conversation.

As we have learned through the course of multiple hearings held by both Committees, there is a broad consensus in support of postal reform. There is a common understanding that the mail is today – and will remain for many years to come – a key part of the nation's communication system. There is a common understanding that the mail is the foundation of a vital industry that is a large and important contributor to the nation's economy. In short, there is a common understanding that deliberate and measured action must be taken to protect the right of everyone in America – no matter who, no matter where – to affordable, universal postal service.

Without needed change, mail may cease to be affordable. Without affordability, what our nation takes for granted as universal service – six-day delivery to virtually every address in America – will be in jeopardy.

Within that context, we have the opportunity and the obligation to develop the right solutions to the challenges facing the nation's mail system so that every family and every business in America continues to enjoy – and benefit from – affordable, universal mail service.

The nation's elected leaders rose to a similar challenge more than three decades ago when they enacted the Postal Reorganization Act of 1970. The business model they created – which was the right model for its time – was effective. As a result, the Postal Service is self-sufficient. Postage rates have largely tracked the rate of inflation. And, by the end of this fiscal year, we will have achieved the Act's mandate that the Postal Service "break even" over time.

However, in the course of only a few short years, we have seen the assumptions of that 34-year old business model rendered obsolete. That model relied on continuing mail volume growth to generate the revenue necessary to fund the costs of expanding our network to meet the needs of a growing nation. This is no longer the case.

Mail volume has declined in each of the last three years, dropping more than five billion pieces from its peak in 2000, representing $4.5 billion less in revenue. During the same three-year period, the number of addresses we served increased by 5.4 million. This combination of factors – declining mail volume contrasted with the costs of a still-growing service network, resulted in a net loss in three of the last four years.

An analysis of volume trends also reveals fundamental shifts in the mail mix. In 2003, reflecting an ongoing trend, First-Class Mail was less than half of total volume. The impact of technological advances, especially on First-Class Mail, demonstrates that profound structural changes in how consumers and businesses communicate are at work. Electronic communications are increasingly being used for transactions that, in the past, have almost universally taken place through the mail.

The robust growth of private-sector services delivering packages and time-sensitive communications has also altered the competitive landscape. These factors will contribute to a diminished rate of mail volume growth and, perhaps, an absolute decline in volume, even as the delivery infrastructure, and its associated costs, continues to expand.

First-Class Mail has been, historically, the greatest supporter of our universal delivery network. It has also experienced the most significant volume erosion, declining by more than 3 billion pieces from 2002 to 2003. While Standard Mail volume grew by 3 billion pieces over the same period, its overhead contribution is only one-third that of First-Class Mail. Standard Mail would have to grow at three times its present rate to balance the loss of First-Class Mail. That level of growth is unlikely. In 2003, we experienced modest growth in package services, but total package volume, at 1.1 billion pieces, is only one percent of First-Class volume. No other class – or combination of mail classes – can produce the volume growth necessary to offset the decline in First-Class overhead contribution. This has placed extreme pressure on our bottom line.

As we proceed with consideration of reform, we must be clear that our goal is preserving and protecting a *national* postal system. And that system is far more than simply the organization called the Postal Service. It is also composed of commercial mailers, nonprofit mailers, industry organizations, consumers, suppliers, current and former Postal Service employees, the organizations that represent them, and everyone else with a stake in the continuation of this vital, national service.

During this critical conversation, we have heard from many of them. Some have suggested that the Postal Service should not have authority to pursue innovative pricing practices widely used in the private sector. Some have suggested that our long and successful history of worksharing, which has held down our costs and contributed to substantial mail volume and industry growth, should be ended. Some have suggested that that the Postal Service operate within the limits of a price cap, but without the necessary level of flexibility to manage significant elements of our costs. Some have suggested that our ability to compete be limited by our withdrawal from certain product categories.

Despite the differing purposes and priorities of these groups, each has one thing in common – reliance on a postal system that meets the special needs of each while serving the common needs of all – affordable, accessible, universal mail service. To assure this outcome, each must be engaged and prepared to be a part of the process of change. We cannot succeed if any one expects only the others to be affected. Nothing can be off limits.

I recognize, too, that as we collectively explore the options available to us, the Postal Service also has the obligation to demonstrate that it is managing its business as effectively as possible.

That is what we are doing. Since I assumed the role of Postmaster General, transformation of the Postal Service has been our central focus. And I am pleased that the President's Commission on the Postal Service acknowledges that our Transformation Plan is guiding us to substantial progress in adapting to an uncertain future. Clearly, it is taking us in the right direction as we improve operational efficiency, add value to our products and services, and enhance a performance-based culture.

While the Transformation Plan became our organizational vision in 2002, the ongoing process of transformation began before then through our breakthrough productivity initiative. The year 2000 marked the first of a record four straight years of increases in total factor productivity.

Even without the effect of our change in payments to the Civil Service Retirement System, we have delivered $5 billion in cost savings since 2000. This includes $2.7 billion in savings resulting from Transformation Plan initiatives over the past two years. We are on track to surpass the $5 billion in savings called for by the Transformation Plan over the five-year period ending in 2006.

We are closely examining other opportunities for cost savings, as well. The continuing decline in single-piece, First-Class Mail, combined with the advances we have made in our automated mail-processing environment will provide opportunities for changes to our distribution and transportation network.

We have reduced our career employee complement by more than 85,000 – a reduction of more than ten percent from its peak level in 1999. That is a reduction of an additional 15,000 positions since I testified before the Governmental Affairs Committee in November and 5,000 positions since my appearance before the Special Panel on Postal Reform and Oversight in January. Fewer than 70 American companies have as many as 85,000 employees on their rolls.

Consistent with our Transformation Plan goal of enhancing a performance-based culture, we have established pay-for-performance systems for managers, executives, postmasters and supervisors. The new system links 100 percent of all pay increases to performance. We have improved the workplace environment, measured both by reductions in grievances awaiting arbitration and quarterly employee surveys.

We have brought service performance and customer satisfaction to the highest levels in our history. We are aggressively managing the business. This will not change.

In addition to the Transformation Plan strategies that have contributed to these successes, the recent legislation adjusting the Postal Service's payments to the Civil Service Retirement System helped us achieve a welcome and needed level of financial stability.

In 2003, extremely focused efforts in managing our business and the impact of the Postal Civil Service Retirement System reform legislation, combined to result in a net income of $3.9 billion. Even without the welcome relief of the CSRS legislation, continued cost reductions and increased productivity would have resulted in a net income of $900 million – a fifty percent increase over plan.

We are particularly grateful for the understanding and cooperation of Chairman Collins, Chairman Davis, members of Committees represented here today, as well as the Administration and the General Accounting Office for their prompt action in addressing Postal Service retirement obligations.

By partially correcting Postal Service CSRS funding requirements, the legislation will allow us to hold rates steady until 2006. It has contributed to our ability to reduce outstanding debt by more than one third – from $11.1 billion to $7.3 billion – in fiscal year 2003. It will help us reduce debt even more this fiscal year.

This same legislation, however, creates new financial obligations that increase costs and place unnecessary upward pressure on rates, but provide no direct benefit for ratepayers and users of the mail. And, because these costs have a long-term future impact on our financial situation, we strongly believe they must be addressed immediately.

First, as I have stated previously, the Postal Service should not be responsible for funding CSRS retirement benefits earned by postal employees while they served in the military. This $27 billion obligation, $17 billion of which represents a retroactive charge to 1971 and which has already been paid to retirees, should be returned to the Treasury. Military retirement costs have no connection to the operation of the Postal Service or the services it provides. The nation as a whole benefited from the periods of military service involved – most of which predated the creation of the Postal Service – and, as such, the associated costs should not be borne by postal ratepayers. The President's Commission shares our view on this matter.

Second, the Postal Service proposes the elimination of the escrow account requirement established by the CSRS legislation. This provision requires that, after 2005, the "savings" resulting from the legislation be placed into an escrow account pending Congressional authorization for their use. The "savings" represent the difference between the Postal Service's new CSRS payment schedule and the old. The simple fact is that, under present postage rates, there will be no funds available after 2005 to place in the escrow account. While we will be paying less for our CSRS obligations, by 2006 any "savings" will have been consumed by inflationary cost increases for employee compensation, benefit expenses for active and retired employees, and for supplies and services associated with serving an expanding delivery network.

The escrow account will be funded by postal ratepayers through higher postage rates. That is because it will be necessary to raise rates in 2006 beyond what would be required simply to offset inflation. We estimate that the escrow requirement, by itself, will result in a 5.4 percent rate increase. This could mean that the average rate increase sought for 2006 could be in the double digits.

Given the continuing diversion of high-contribution First-Class Mail to other channels of communication, maintaining the escrow requirement could accelerate this diversion, exacerbating the problems legislative reform is intended to address.

As I said, the Postal Service strongly urges the elimination of the escrow requirement and the enactment of our preferred proposal. If enacted and the military retirement funding requirement is transferred back to the Treasury, the Postal Service would have fully funded and, in fact, over-funded our CSRS payment obligation. We would then be in a financial position to pre-fund post-retirement health benefit obligations on a current basis.

In previous appearances before both the Committee on Governmental Affairs and the Special Panel on Postal Reform and Oversight, I have discussed specific recommendations made by the President's Commission on the Postal Service in its final report. I have also expressed my support of the five key principles that the President urged Congress to consider in enacting postal reform legislation. I will briefly review the Postal Service's position on each of these issues.

We agree that the Postal Service should take advantage of corporate best practices. We will continue our pursuit of private-sector strategic partnerships where they help us enhance efficiency, reduce costs or improve service. We will continue to work with the mailing industry to expand worksharing to encourage the use of the mail and contribute to more efficient operations for the Postal Service.

We will continue more innovative approaches to how we buy products and services – including the revision of our purchasing regulations – to reflect corporate best practices such as supply-chain management. Our success in this effort will depend largely on our ability to leverage our size to obtain the best value for every dollar spent on supplies and services. We can maximize cost savings in our buying activities only if every purchasing decision is driven by best value. Our ratepayers deserve nothing less.

We agree with the principle of transparency. While the President's Commission noted that, in many respects, our reporting often exceeds what is required of Federal agencies, we are enhancing financial reporting in a number of key areas. These include annual and quarterly financial reports and enhanced disclosure and reporting of significant events reflecting SEC-type reporting requirements of publicly traded companies.

We agree with the principle of flexibility. In short, management must have the flexibility to manage by having the authority to reduce costs, set rates, and adjust its business to meet its obligations to customers in a dynamic marketplace. I consider this the litmus test of postal reform.

In certain key areas – the determination of funds needed to operate the system and adjustments to our retail and processing network to meet changing conditions – the Commission has proposed that other bodies, either the proposed Postal Regulatory Board or a new Postal Network Optimization Commission, assume these responsibilities. This distances the operators – those with the day-to-day responsibility of running the postal system – from key decisions, reducing rather than increasing management flexibility.

We agree with the principle of a self-supporting Postal Service. A reformed pricing regime can help produce this result by providing the flexibility to respond to market needs while covering costs.

A self-supporting Postal Service would also include our ability to retain earnings, a concept called for in our Transformation Plan and endorsed by the President's Commission. This would provide a revenue stream that could finance capital expenditures and "smooth out" business cycle impacts on overall financial performance.

I have pointed out that declines in mail volume and changes in the mail mix present us with an extremely challenging revenue outlook. With that in mind, we are continuing to identify and pursue growth opportunities. As we face an uncertain future, the Commission's recommendation restricting Postal Service activities primarily to those offered today could prove to be unnecessarily limiting to future revenue opportunities that would protect our ability to provide universal service.

We agree with the President's fifth reform principle of accountability. With increased management flexibility, there must be an appropriate level of independent oversight to protect the interests of all mail users. Yet the Commission's proposed Postal Regulatory Board would have the authority to revisit the letter and mailbox monopolies and universal service. From our perspective, these are broad public policy issues – not regulatory issues. There should be standards drawing a clear line between what is appropriately a managerial function within the oversight of the Governors or Directors, what is a regulatory function committed to the regulator, and what is a public policy function reserved to the nation's lawmakers. Of course, accountability must also be a part of every Postal Service activity, as well.

To the President's list of five guiding principles for reform, I would add a sixth: a commitment to the collective-bargaining process. The give and take of the process assures that interests of our employees and our customers are considered within the larger picture of the Postal Service's financial situation. We agree with the Commission that a more efficient process can benefit all parties and that the addition of a mandatory mediation step – if negotiations have not resulted in a new agreement – could help forge a final resolution or limit the issues that must be addressed if interest arbitration becomes necessary.

The President's principles for reform provide an important framework that can guide the development of an effective new business model for the Postal Service. And, as we work within the constraints of today's model, we are taking every opportunity to drive growth by adding value to our products and services.

In the area of rates, we have developed an innovative negotiated service agreement with one of our largest mailers. By reducing costs for the Postal Service and the mailer, the agreement allows us to offer rates that encourage increased First-Class Mail volume. Early results indicate that this approach is successful and we are working with other mailers on similar agreements.

To increase the use of our traditional products, we are using technology to add value to the mail through the development of new features and services. Our Confirm service – one of the first of our Intelligent Mail initiatives – provides the Postal Service and mailers with a rich stream of information about mail as it moves through our system. It helps the Postal Service improve processing efficiency and helps mailers better achieve their business objectives.

For the Postal Service, the concept of retail is no longer simply the four walls of the Post Office. Our popular website, www.usps.com, lets customers purchase postage, obtain mailing information, change their address, have their mail held, create and print address labels with or without postage, request free carrier pick up of prepaid packages on the next business day, get information about the delivery of their packages, and create and mail greeting cards. USPS.com brings the Post Office right to millions of American homes and businesses, making the use of our products and services quicker, easier and more convenient than ever.

We have developed creative new products that help mailers make their message stand out from the rest. We have made it easier for customers to return merchandise. And, through strategic partnerships with other delivery firms, we are taking better advantage of one of our core strengths – the "last mile" of the delivery process.

Clearly, with service performance at an all time high, with customer satisfaction at record levels, with innovative products and services, and with an expanded period of rate stability, mail today offers better value than at any other time. We will stay focused on enhancing the value and relevancy of mail.

Yet we are faced with structural issues of such magnitude that, if left uncorrected, will transcend market opportunities, exhaust our ability to reduce costs, and, frankly, require us to think about the unthinkable: how long can we afford the cost of universal service as we know it today?

Despite our success in cutting costs over the last four years, this very success in this area restricts future opportunities for cost control. We have aggressively managed costs and managed the servicing of our expanding delivery network. As our costs continue to rise, we must recognize that a significant portion of Postal Service costs originates with requirements imposed on us by legislation. If reform is to succeed, these cost issues must be addressed. That is why future legislation has to provide flexibility in this area.

For example, International Mail is an area in which we have been given greater freedom over pricing and products. But there are greater restrictions on international air transportation. This is because the Department of Transportation determines the rates we must pay airlines. The Postal Service cannot negotiate directly with carriers for international air transportation costs as we can – and do – for domestic mail, which has allowed us to remove significant domestic transportation costs.

This lack of flexibility in international transportation is a significant cost barrier. Our annual costs in this area are nearly $200 million per year. Market-based pricing could reduce that by more than half, to less than $100 million. Change in this model would reduce Postal Service costs and, perhaps, international rates. By being able to offer market-based rates in this highly competitive area, we would have an exceptional opportunity to increase mail volume by providing more affordable options for our mailers.

There are also savings opportunities connected with appeal procedures available to our union-represented employees. Today, these employees may select a number of different dispute-resolution procedures for the same issue. These include the contractual grievance-arbitration procedure and the Equal Employment Opportunity appeals process. These two forums can produce conflicting resolutions and, in some cases, resolutions that are at odds with equity issues established through collective bargaining. The collective-bargaining process should result in labor agreements that allow the parties to resolve workplace disputes through processes they have created and which they control.

We strongly believe that a single appeal process – one that is the product of agreement between the parties – can protect the rights and interests of employees, their representatives and the Postal Service.

By far, the largest single category of costs beyond our span of control is employee benefits. More than 70 percent of Postal Service costs are personnel-related. And benefits constitute more than 25 percent of personnel costs. We have proposed that the collective bargaining process, which covers almost 90 percent of our career workforce, be expanded to include the negotiation of benefits in addition to wages, hours and conditions of employment. In short, everything should be on the table. Some of the key benefit programs enjoyed by our employees, because they are mandated by statute, are currently beyond the scope of collective bargaining.

In 2003 alone, nonnegotiable benefit costs, including retirement contributions, health benefits, life insurance, retiree health benefits and workers' compensation represented more than $13 billion – twenty percent of our operating expenses. These costs continue to increase year to year at rates exceeding normal inflation. While the Postal Service negotiates the employer share of health benefit premium payments with its unions, the actual premium costs and benefits offered by the plan are established by the Office of Personnel Management. The workers' compensation program available to our employees was established by statute and is administered by the Department of Labor. Similarly, annuity payments and health benefits for Postal Service retirees are established by law, not by collective bargaining.

Benefit costs have grown from $7.9 billion in 1990 to $16.1 billion in 2002. While the impact of the Postal Civil Service Retirement System Funding Reform Act of 2003 reduced benefit costs to $13.3 billion in 2003, we expect benefit costs to re-escalate beginning in 2004, rising to $20.8 billion in 2010.

During the past 20 years, postal benefits have grown at an average annual rate of 5.5 percent. This compares to the private sector annual growth rate of 4.4 percent.

The solution to this issue is managing benefit costs, ideally by bringing them within the purview of collective bargaining or by adjusting them through statute. It is not our intention to reduce the benefits already enjoyed by current and retired Postal Service employees. Benefit negotiations would affect only eligible employees entering the Postal Service following the conclusion of negotiations.

Workers' compensation represents a sizeable portion of our compensation and benefit costs. In fiscal year 2003, $1.5 billion in workers' compensation costs accounted for 2.9 percent of our total $50.5 billion in compensation and benefit costs. At the end of 2003, total liability for future workers' compensation costs was $7.1 billion. In 2003, an additional $704 million was paid in compensation and benefit costs for employees with work-related injuries in either limited duty or rehabilitation positions. We are also responsible for $122 million in workers' compensation costs incurred by the Post Office Department prior to 1971.

The best way to limit workers' compensation costs is through a strong safety program that helps to reduce the number of work-related injuries and illnesses. Our program is doing that. From 2001 through 2003, workplace injuries were reduced by an impressive 28 percent. But workers' compensation expenses, which were $970 million in 2001, grew by more than 50 percent, to $1.5 billion in 2003.

The magnitude of workers' compensation costs has been a concern since the early days of postal reorganization. Although these costs were moderate in the years immediately following reorganization, they grew significantly with the 1974 amendments to the Federal Employees Compensation Act. Among other changes, these amendments eliminated the reduction in the level of workers' compensation benefits at age 70 and eliminated the immediate, three-day waiting period before benefits could be paid. The waiting period was moved from the date of injury to three days after the end of the 45-day period of continuation of pay received from the Postal Service by an injured employee.

The President's Commission has recommended statutory changes affecting workers' compensation in the Postal Service. We support these recommendations, which can significantly reduce costs, and urge their adoption.

One recommendation is that postal employees on workers' compensation rolls have their compensation reduced at some point to reflect the fact that they would likely have retired were they not on the rolls of the Office of Workers' Compensation Programs. A recent review by the Office of Inspector General found that 2,819 – or 21 percent – of the more than 13,000 Postal Service employees on workers' compensation are classified as totally disabled and, as a result, not expected to return to work. Of that group, almost 90 percent – 2,502 – are age 55 or older and likely to be, for the most part, retirement-eligible.

Our own analysis shows that for two similarly situated retirement-eligible employees, one who selects optional retirement and the other who continues on the OWCP rolls, there is a disturbing disparity. Over a ten-year-period, the employee who continues receiving workers' compensation receives $95,000 more than the employee who retires.

Another of the Commission's recommendations regarding workers' compensation involves reinstating the three-day waiting period before an employee is eligible to receive 45-days continuation of regular pay rather than after the 45-day period. This is consistent with individual state workers' compensation programs that require a three- to seven-day waiting period before benefits are paid. An appropriate waiting period in the Postal Service should exist at the beginning of the coverage period, as is the case in the private sector.

In the area of employee health benefits, we expect annual costs to increase, on average, $418 million through 2010. Implementing private sector practices in connection with plan design and efficiency could provide the opportunity to improve the delivery of benefits and reduce costs. This would require mandatory bargaining of this benefit with our unions.

Retiree health benefits are now defined by federal law. We project annual cost increases of more than 16 percent – some $228 million annually – for this benefit through 2010. We believe that changes are possible that address cost concerns as well as issues of fairness. Today, benefit levels are the same for an employee who has worked for five years or for thirty-five years.

We expect cumulative costs for all benefit categories to rise by about $1 billion per year over the next six years. Clearly, there are opportunities to control the unrestrained growth of these costs while, at the same time, protecting the legitimate interests of Postal Service employees. I urge that you consider these approaches as an integral part of any comprehensive reform legislation.

Any discussion of Postal Service costs – particularly those over which we have limited control – must inevitably lead to a discussion of postage rates and possible price caps. Price caps have been at the center of the various reform bills that have been offered over the last several years in connection with the Postal Service's call for pricing flexibility – a flexibility that could provide sought-after predictability for mailers.

At their best, price caps would accurately be set against the reality of postal costs and revenues within a given time period. Yet, as we have learned since 2001, the volatility of today's mail market has defied projections. Just four years ago, the Postal Service's *Five Year Strategic Plan, 2001-2005* projected a mail volume of 230 billion pieces for fiscal year 2004. Even with the Plan's "rapid diversion" scenario, the Plan projected mail volume of 213 billion pieces in 2004. This year, our projections call for no significant change from 2003 volume of 202 billion pieces. As volume falls, particularly for First-Class Mail, revenue obviously declines, as well.

An appropriately constructed price cap will allow the Postal Service to recover costs over which it has little or no control. As I have explained, there are significant cost drivers beyond our control. The Postal Service is particularly vulnerable to increasing fuel costs, given our need to transport mail to and from 38,000 facilities and to more than 141 million addresses six days a week. Other delivery and trucking firms, including FedEx and UPS, routinely impose fuel surcharges to deal with increasing costs. In addition, our network must grow each year to accommodate average annual growth of more than 1.8 million new addresses. In terms of inflationary pressure, the statutorily mandated benefits costs for employees and retirees, including health benefits, workers' compensation and annuities, are of even greater concern. We believe the Postal Service should be able to bargain over these benefits. If we do not receive that flexibility, then these costs must be recognized in the pricing scheme.

Finally, the price cap must take into account a cost for which the Postal Service and its unions bear full responsibility: wage increases. The Postal Service, due to the very nature of the service it performs, is far more labor-intensive than most other employers. The Postal Service believes that the Employment Cost Index (ECI) wage series, the broad measure of wage gains in the economy as a whole, represents an appropriate metric for this component of our costs.

Each of these factors must be considered in the construction of a price cap. While a number of models have been discussed, using a variety of indexes, it is clear that Postal Service costs are, in many ways, different from those of other industries and businesses. Therefore, the success of a price cap is entirely dependent on its ability to accurately project and reflect postal costs during the covered period. We believe the appropriate price cap, therefore, would be made up of at least four components: a fuel index, a network expansion index, the actual growth in statutory benefits, and ECI wages. There may be other factors that should be taken into account, as well.

This price cap does not envision a continuation of the present "cost of service" price regime. It will take aggressive management by the Postal Service to successfully operate at or below the cap. The reason is simple. Unlike other regulated networks, the Postal Service imposes no separate charge for delivery. The Postal Service must generate sufficient revenues to simply maintain a network – our 347,000 letter carriers and our 38,000 retail outlets.

First Class Mail, the Postal Service's flagship product, contributes about $17 billion toward coverage of this expense. Yet, First Class Mail volumes have declined the last three years. In Fiscal Year 2003 alone, this decline represented a loss of $642 million in contribution to network costs. The need to recoup this loss of contribution would, in and of itself, cause an added increase in the rates sought by the Postal Service in the next case it files under current law. However, under the price cap I have described, the Postal Service, if it were to operate successfully under the cap, would have to offset lost contribution with productivity gains.

Given the very real volatility in today's mail market, my very real concern is that an imperfectly crafted price cap would be unworkable. That could require the Postal Service to file an exigent rate case as the rule rather than the exception. If that were to occur, it would defeat the purpose of a price cap and, in raising rates beyond those defined by the cap, contribute to even greater mail volume decline, leading to a vicious spiral of destructive rate increases.

For this reason, should price caps be a part of postal reform legislation, I urge you to consider, thoroughly and carefully, the construction of a price cap regime that drives maximum operational efficiency but does not undermine the legitimate financial needs of the organization and the level of service provided. Should you leave the determination of the appropriate pricing scheme to the regulator, we believe Congress must provide adequate guidance to ensure the regulator considers these important factors.

This price-cap regime could eliminate a cumbersome rate-setting process and result in smaller, annual increments that can be absorbed by our commercial customers. At the same time, we strongly believe that marketplace uncertainties mandate that a price cap be just one element of comprehensive reform legislation that provides the Postal Service with flexibility in other critical areas.

Like each of you, the Governors of the Postal Service and its senior management have devoted a great deal of time to the consideration of the many different elements that would be part of a successful legislative reform initiative. Just a few short years ago, we could not have predicted that the President would have established a Commission to examine the problems facing the postal system and recommend solutions. Just a few short years ago, we could not have envisioned that the Senate and the House of Representatives would hold a joint hearing as the culmination of months of independent hearings on this subject. And just a few short years ago, we could not have imagined that First-Class Mail volume had reached its peak and would begin what appears to be an inevitable and, possibly, permanent decline.

Looking ahead just a few short years, it is likely that today's projections, today's assumptions and today's analyses may be just as obsolete as those of just a few short years ago. The legislative approaches we have considered may have been sufficient had the dynamics of the mail market conformed to our expectations. They have not.

The solutions we are considering today may provide financial stability for a limited period. But electronic diversion will continue to occur – and at a more rapid rate than we are experiencing today. Even the most carefully constructed price cap will result in rate increases that will accelerate the decline in overall mail volume. If we do not significantly restrain costs that are not under our control, we threaten the affordability of the mail, further eroding volume and revenue.

If we are to succeed in this effort, we must expand our thinking. We must reconsider the definition of universal service as we know it today. Can we continue to afford six-day mail delivery, at a single price, to virtually every home and business in America? As we prepare for the future, our deliberations must include this critical issue. And, depending on how we answer this question, we must consider who will make this decision and how it will be implemented.

It is not my intention to reduce mail delivery from six days to five. I have previously stated that this will not happen on my watch. I have not changed my position. But, as Postmaster General, it is my obligation to bring this issue, which could be central to the ultimate success of our reform efforts, to the conversation.

Finally, I want to comment on two issues raised at an earlier hearing by our competitors. The first concerns the postal monopoly. In his testimony, Fred Smith, CEO of FedEx, made the claim that "the postal monopoly is rendering the Postal Service unfit to compete and prosper in the delivery services sector of the future." His proposition rests on the notion that by creating a "protected market," the Private Express Statutes make it virtually impossible for the Postal Service to be efficient.

That is simply not the case, as our record of service performance and cost reductions clearly indicates.

The worksharing partnerships we have formed with mailers over the past 25 years also attest to the efficiencies gained by mailers who perform the work of preparing their mail for automated processing and delivery by the Postal Service.

And Michael Eskew, Chairman and CEO of UPS, in his statement to the Committee on Governmental Affairs earlier this month, said, "The Postal Service's mail monopoly allows it to subsidize competitive products and inappropriately compete with the private sector."

That statement misses the mark on both counts. First, the Postal Service's monopoly on letter mail does not subsidize competitive products. In fact, as First-Class Mail volume continues to decline, so too does its contribution to system costs. I would point out, too, that in 2003, our competitive products, Express Mail, Priority Mail and Package Services contributed $2.5 billion to system costs.

But there is an even bigger misconception in Mr. Eskew's statement. The Postal Service is prohibited by law from cross-subsidization. Period. And one of the duties of the independent Postal Rate Commission is to ensure that this does not occur.

The reference to "inappropriate competition" with the private sector ignores an important lesson of history. At the turn of the 20th century, by law, the Post Office Department was not permitted to carry parcels weighing more than four pounds. Only private express companies delivered larger packages.

Back then, more than half of the American public lived in rural areas, many of whom received no parcel delivery from private carriers and, for some who did, only at extremely high rates.

When the Parcel Post Act of 1912 was enacted, all that changed. It was an instant success. Three hundred million parcels were mailed in the first six months the service was offered. The new Parcel Post service launched a multi-billion-dollar mail-order catalog business in America. For the first time in history, rural residents were able to use the mail to receive the goods they needed at affordable rates. Even today, almost a century later, that holds true, as the Postal Service delivers to every address – city or country – without a residential or rural surcharge. This remains at the heart of today's promise of universal service.

Through the efforts of so many in Congress, the Administration and the mailing industry, we have reached a point of virtually unanimous agreement about the need for postal legislative reform. I believe we are closer today to achieving this goal than we have ever been.

I believe that, working together, it is possible to achieve proper balance between increased flexibility for the Postal Service and an effective level of independent oversight. In achieving that balance, we have the opportunity to create a legacy of customer-responsive service that serves everyone in our nation equally – and equally well.

As Postmaster General, I do not seek change for the sake of the Postal Service. Rather, as their common agent, the Postal Service seeks change for the sake of every individual, every family and every business that relies on the mail.

Yes, there are challenges connected with the next steps, but the rewards for the people of our nation cannot be understated. If we are successful in our efforts, we will preserve the right of every American to affordable, universal mail service. That is what we provide today. That is what we want to be able to provide for many years to come.

Again, I would like to take this opportunity to offer my gratitude to Chairman Collins and Chairman Davis for holding today's joint hearing and the many hearings that preceded it. It is clear that there is a real interest among the members of both Committees in creating a new business model that will protect this basic public service for many generations to come. I look forward to working enthusiastically and cooperatively with you in pursuit of our common goal.

Thank you. I will be happy to answer any questions you may have.

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Chairman TOM DAVIS. Thank you very much. Let me ask Mr. Roseboro. I heard the Secretary's testimony about the escrow money and the deficit, but this really isn't deficit money, this is postal ratepayer's money that they paid into the fund, right?

Mr. ROSEBORO. Yes, it is.

Chairman TOM DAVIS. Why would you use it for other—I mean, I don't think we ought to be under the illusion this money is going to be paid for the Defense Department or the Education Department. These are postal dollars paid by ratepayers under a fund that is akin to an enterprise fund.

And under State law in Virginia, if I had taken money from an enterprise fund and used it or amassed it for anything else, I would go to jail. But at the Federal level, we don't have those rules. So you can sit here and use this to, "mask a deficit when it is to phoney baloney." These are postal dollars that ought to ultimately be used for the Post Office.

I am trying to understand for $3 billion this year, which is what is in there now, why don't we just call it what it is, and postal dollars, and release it?

Mr. ROSEBORO. You are absolutely correct from the perspective that you would look at this $3 billion which would grow in terms of the escrow structure. While I would say, however, I disagree that it is attempting to mask any deterioration in the deficit.

What our concern is, from a budget scoring proposition, a budget scoring proposition that was built into last year's legislation, is that it remain a strong preference that it remain budget neutral. And to accomplish that from a budget scoring perspective, that is where we think we need to aid the committee, aid the Congress in trying to determine what makes sense, what, if anything, can work, and we are willing to lend a hand.

Chairman TOM DAVIS. Well, isn't it budget neutral simply because of the way that the scorers look at these things? They had counted this money as basically general fund money. If you shift it to the Post Office, then it shows up as a deficit on the general fund side, and it is used for postal—am I understanding it correctly?

Mr. ROSEBORO. It is an accounting budget scoring issue, absolutely, sir.

Chairman TOM DAVIS. So the alternative, if you keep it neutral, is that ratepayers would have to pay an additional $3 to $4 billion a year, not for any purpose that has anything to do with the Postal Service or its employees, but basically to reduce the deficit. And the alternative is that you raise postal rates, which has—you talk about a tax increase, that is what postal rates are. You talk about trying to get jobs in this country, that is a job killer in my opinion.

Now, what am I missing here?

Mr. ROSEBORO. We would look at it as that isn't necessarily the only alternative that could be structured, and again we would work to explore other reasonable alternatives that do not have that outcome which you just outlined.

Chairman TOM DAVIS. I am just—I hear you. I really appreciate the Secretary's remarks about how he wants to look at finding offsets with this, and we have—I guess if we have to do that, that is what we have to do. But it just seems so much cleaner and

straighter and more honest to just say these are postal dollars, we are going to release them and let the chips fall where they may on the budget, because ultimately those are dollars that shouldn't be put in the same fund as taxpayer dollars. These are ratepayer dollars. The way the Postal Act is set up is so the Post Office could pay for itself.

Now you are saying dollars that they generate, we are going to take these dollars away and put them over here, so at least for accounting purposes these look like dollars that are raised from income tax.

Mr. ROSEBORO. Well, again, we think there may be other alternatives. Again in terms of exploring those options, in terms of those dollars being directed toward other postal obligations, the frequently mentioned here unfunded obligations of substantial nature.

Chairman TOM DAVIS. Let me ask you. What would a 5.4 percent across the board postal rate increase do to the economy?

Mr. ROSEBORO. We think that any increase would not be a good thing. However, recognizing the reality of other options being available, other leverage to push in a structure, in a business, of 42 percent unallocated costs, that there could not be explored, could not be found other cost saving measures, as we push for the Postal Service to have flexibility with regard to technology, with regard to work force issues where it has a great opportunity in the coming years with regard to natural attrition, eligibility for retirement increasing.

We think it is not just a binary issue of raising rates or pushing the expense onto the taxpayers, we think there are some other options that could be practically explored.

Chairman TOM DAVIS. I am encouraged by the fact that you want to work with us and recognize the problem at the end of the day if we just leave those dollars over there without finding some—and we look—I like the straight up way of doing it, that is kind of—but we look forward to working with you on that, and appreciate your commitment.

Mr. Davis.

Mr. DAVIS OF ILLINOIS. Thank you very much, Mr. Chairman. Mr. Potter, Secretary Snow indicated that there were still efficiencies to be found in the Postal Service. Would you comment on where some of those might be?

Mr. POTTER. Well, over the past 3 years we have worked very hard to find productivity improvements throughout our system. Some of the cost saving opportunities are in the supplies and services, the transportation that we procure, some of the services that we buy such as leases on buildings.

In the past 3 years, we have managed to reduce our spending on that by over $1 billion. In addition to that, we have taken out over $1.7 billion worth of labor cost simply by managing our business better. We have done an internal benchmarking program that has our employees focused on productivity.

And our employees are stepping up to the plate. So I see productivity improvement opportunities in every operation that we have. I think our employees are engaged in that, and the product is what you see. You see a reduced work force that is taking on additional work, and productivity that is growing.

So I see opportunities in delivery. I see opportunities in mail processing operations. I see opportunities in all of the supplies and services that we buy, and we have a very broad program. As the Secretary said, there are 16 areas that were recommended to us by the President's Commission, and we are exploring each and every one of those opportunities.

Mr. DAVIS OF ILLINOIS. If we were to try to make up the $27 billion in military retirement costs, do you have any idea how long that might take using these efficiencies?

Mr. POTTER. Being extremely aggressive, we are able to take about $1 billion cost out in a year without disrupting the service to the American public, and service is the No. 1 goal in our organization. We don't want to do anything dramatic that would cause us to disrupt service.

I think the horizon is decades in terms of getting at the $27 billion on top of what we have already planned to do because our plan calls for $1 billion in savings over each of the next 3 years in order to try and mitigate increases in postage.

Mr. DAVIS OF ILLINOIS. Mr. Roseboro, do you think that those are the kinds of efficiencies that the Secretary had in mind?

Mr. ROSEBORO. Yes, sir. As was indicated, the Postal Service has made a great start. There is still room for considerable improvement looking forward. With regard to your specific concern, Postmaster General Potter spoke to the Secretary before he left about the $27 billion being shifted over to the Post Office.

If I may sort of put that into a context, which will hopefully help make clearer our position on that, why we think that is reasonable. First, we look at in the context of the legislation that was passed last year, last April, a package of reform, a package of reform that was quite unique in that the Postal Service was the beneficiary of a dynamic analysis with regard to its pension funding, that effectively resulted in, even with the obligation as the legislation passed last year required, for the Postal Service to pay the $27 billion in military funding, it still received a net gain of $78 billion.

And even with that $27 billion, I would like to just note this has also got lost, that there is still an obligation by the Treasury taxpayer to pay close to $21 billion of military obligations. So as a package, it was fair, reasonable, as well as consistent with establishing the Postal Service system, consistent with the Federal Employees Retirement System [FERS], where that is a requirement to pick up the military obligations by agencies, and the Postal Service now has, correct me if I'm wrong, Postmaster Potter, over 500,000 of its employees are now under the FERS system.

So from our perspective, that was very important. But with regard to looking forward and in managing the $27 billion liability, I would say actually the challenge is greater than that. There is the additional $60 billion in unfunded health care liabilities, $7 billion in unfunded worker's compensation liabilities, a little under $6 billion in unfunded pension liabilities still.

All of those we feel needs to be addressed, as practically speaking made part of a rate case, recognizing the impracticality of looking to do anything dramatic soon and cause any type of spike in rates.

We think we can work with the Postal Service through the Office of Personnel Management, for example, to devise a prudent amorti-

zation plan over the long term, because these are long-term liabilities, to minimize any shock as well as also being able to gain some of the cost savings opportunities that the Postal Service is now and in the future will be pursuing.

Mr. DAVIS OF ILLINOIS. Thank you very much. It sounds like we are saying no matter what we are able to do we are still going to be woefully short and are going to have to come up with something else.

Chairman TOM DAVIS. Thank you. Senator Collins.

Senator COLLINS. Thank you, Mr. Chairman.

Postmaster General, one of the troubling developments that you have had to deal with is the decline in the volume of first class mail in each of the last 3 years.

Can you tell the committee what your forecast is for the next year or so as far as the volume of first class mail? Are you projecting further declines?

Mr. POTTER. We are projecting that next year, and we are working very hard to do this, we are projecting that volume basicaly will be flat, although it may grow a little. And the reason we do, and that is only in the next year, is because of the recovering economy and the efforts that our employees have made to improve service and to reach out to customers.

However, when you will look further, beyond that, the structural change, the movement of what is a hard copy communication today, it could be a bill or a payment that is done via the mail, we see the structural change of that migrating to the Internet continuing.

And so in the short term, given the fact that the economy is rebounding, we are not as hard pressed as we might be in future years. We are preparing ourselves for the future, and that is why we are counting on postal reform to give us the flexibility to react to what we anticipate will be some significant changes in our mail mix.

Senator COLLINS. And if in fact you had to file for a 5.4 percent increase in postal rates because reform was not forthcoming and the escrow account remained in place, wouldn't that likely drive down the volume of mail still further and create what the GAO has warned about, of this death spiral of increasing rates and then plunging volume?

Mr. POTTER. Yes, it would. Each of our products is subject to marketplace elasticities. The higher we raise rates the less mail we have. People have alternatives for every one of the products that we have.

Senator COLLINS. I want to turn now to one of the specific recommendations of the Commission. I believe that the Postal Service has something in the neighborhood of $7.2 billion in liabilities for worker's compensation. Is that in the neighborhood?

Mr. POTTER. Yes, it is.

Senator COLLINS. Right now, as a result of reforms that were passed in the 1970's, it is my understanding that a postal employee who is receiving worker's compensation can remain on worker's compensation, assuming no return to work, forever, that there is not a conversion to retirement at a certain age.

And, in fact, I read one study that indicated the Postal Service was paying worker's comp benefits to an employee who was age 102.

Mr. POTTER. That is correct.

Senator COLLINS. Are you supporting the changes that the Commission recommended to have a conversion at some reasonable retirement age? Obviously our hope would be that we could get any injured worker back to work and that we can avoid injuries in the first place.

But for those workers who do receive worker's comp, do you support, first of all, the conversion at a normal retirement age and, second, the reinstatement of the 3-day waiting period?

Mr. POTTER. On both counts we do. We feel that it is reasonable that at some point in time, and I'm not going to tell you what the age is, in fact right now we would make money if it was 80 years old, at some point in time people should be forced to retire. It is unreasonable to pay those escalating costs. We estimate that on an annual basis it costs us about $9,500 per employee who stays on worker's comp rolls versus them converting to a retirement pay at some reasonable point. So that is a big cost to us.

In addition, the 3-day waiting period was converted in the past, and as a result we saw a rise in claims. If I could, the Postal Service is working very hard on the worker's comp area, and we believe that it starts with injuries and illnesses of our employees, and we have gone very aggressively on a safety campaign to make sure that our employees don't get harmed. Our injury-illness rate over the last 3 years is down 28 percent.

And despite that, our worker's compensation costs have grown. We are also working hard to find other employment if people can't work in the Postal Service, find other employment for those people on worker's comp rolls. Today we have over 200 folks who don't work for the Postal Service but are on our worker's comp program, work for private sector employers, and we make up the difference between what the private sector employer pays them and what they would get on worker's comp.

So we are very interested in this area, and I think that the Treasury and the President's Commission was right to point it out as an opportunity, and we are working hard to fix it.

Senator COLLINS. Thank you, Mr. Chairman.

Chairman TOM DAVIS. Thank you.

Senator Carper.

Senator CARPER. Thanks, Mr. Chairman. Since the tragedy of September 11 and the anthrax attack, something has actually come out of something awful, and I think that something good is improved performance within the Postal Service.

I think the saying "success has many fathers" has been offered. In this case, success has many fathers and mothers, I might add, and maybe one or two of the fathers are sitting at this table before us and some are represented here in the audience of the hearing room.

We have seen remarkably improved relations, working relations between our labor unions which represent postal employees, the Board, the Board of Governors and postal management. And I would ask you, the fruits of those labors, those improved relations,

aren't something that we mandated. We didn't pass a law that said you got to do this. But you have done it.

And just take a moment and just talk about some of the positive steps that have been taken to provide maybe better service at a more reasonable cost. The General and also for Governor Fineman.

Mr. POTTER. I am very proud of the improved labor relations that we have in the Postal Service. I think one of the keys to that is we are focused on the customer, and we put the customer first, and we as an organization have put that as our No. 1 priority. Service is No. 1.

And we do things as efficiently as we possibly can. When you talk about the success in the Postal Service, you talked about the mothers and fathers of it over the last several years, I think there are over 700,000 mothers and fathers of the success. It is each and every employee who comes to work every day, dedicated to serving their customers and who have focused—again, we are in tough times. People recognize that we have to change, and we engaged, long before the President's Commission, we were engaged in the business of trying to improve service to our customers because we recognized we are in a competitive environment, looking at opportunities that we had based on the changing mail mix and changing demographics, to improve the efficiency of the mail that we—of moving the mail flow out of our system.

And I think it has just been an entire organization working together to make that happen. We have seen improvements in our relationship with the unions. And I think that if there is a key to success, is that we communicated, and we have stressed a need to communicate up and down our organization on everything, and we are trying to treat each and every individual in our work force as we would want to be treated ourselves.

It is not to say that it is a perfect system. With over 700,000 people it can't be perfect, but we are working hard to try and achieve that.

Senator CARPER. Governor Fineman, before you respond, General Potter mentioned communicate, better communications, and that solves a lot of problems in many forums. We have had recommendations from the Commission that on the issue of collective bargaining that we mandate through law that you collectively bargain benefits, not just wages but benefits as well.

And I don't know, there is probably some in the House and some in the Senate who are inclined to do that, some who are maybe reluctant. And I would ask for you to, maybe both, be thinking about whether there might be an opportunity, as you communicate and have this dialog between management, Governors and organized labor, maybe an opportunity to dialog on the issue, rather than mandate, us mandating benefits on the collective bargaining, maybe you just voluntarily try that, and particularly before we step in and legislate something.

Mr. POTTER. If I could, let me just tell you that dialog is taking place and will continue.

Senator CARPER. Is there anything that we can do to push that forward?

Mr. FINEMAN. I would just say that I congratulate management. When I came onto the Board, there was not the same tone that was set between management and labor.

Senator CARPER. When did you come on the Board?

Mr. FINEMAN. 1995 or so. There was not the same tone. There was this big backlog of grievances. And slowly, and I think through the previous Postmaster General particularly, and Postmaster General Potter, there is a different tone that is set.

The tone is set that—we understand that at certain times we are going to be adversarial, but at the same time we have to keep talking to each other.

In regard to your second question, I have said publicly before, and in my written statement that I have submitted, that I am a long believer in the collective bargaining system. And I would believe that—I would hope that this committee in drafting legislation will not in any way usurp that collective bargaining system through some other kind of system, some of which is recommended by the Presidential Commission.

I think it has to say—and the reason the collective bargaining works and the reason it is working today is exactly what you said, Senator. It is the question, do you have open communication with people to talk about what your problems are. And if you can have a collective bargaining system in which you set wages, you are going to be talking to each other. You set up a process to keep talking with each other.

Senator CARPER. Well, keep talking. Thanks very much.

Chairman TOM DAVIS. Thanks.

Mr. McHugh.

Mr. MCHUGH. Thank you, Mr. Chairman. To editorialize a bit, Postmaster General Potter mentioned the testimony of UPS with respect to the question of cross-subsidies. It is a very hotly contested issue, one of the very first I heard about some 9 years ago.

And we have tried to come to the resolution, I know that the Postmaster General and others know this, but just for the record come to a resolution that while the debate is interesting and important, it probably can't be decided given today's state of realities.

So what we have done in our bill, as you know, Mr. Chairman and Senator Collins, is to try to create a circumstance where the issue cannot happen in the future if it has happened in the past. And we all heard the Postmaster General's strong denials, which I respect, and we do that by creating a regulatory body, now the Postal Rate Commission, that is given all of the authority it would need to have to make those determinations unquestionably, subpoena power on data, powers it does not now have.

So it certainly—we have suggested to UPS, for whatever faults they may have in the bill, that is something that they should be very, very supportive of.

I also want to associate myself with the comments of just about everyone who has spoken so far with respect to the frustration regarding the escrow.

Senator Collins knows far better than anyone, as she noted, that the interesting dilemma here is that the administration's original bill would actually be more costly to the budget than the ultimate resolution.

And it certainly—this is no fault of the Treasury Department. I think it dramatically underscores the folly of budget scoring as it currently is constructed. And to suggest, and again this isn't Treasury's fault, it is the way the game is played right now, to suggest that a $3 billion hit on the Treasury is better than a 6 percent increase in postal rates to the overall economy and budget situation of the United States of America is lunacy.

And I am just curious again, that this is no responsibility of yours, Mr. Secretary Roseboro. But I am wondering, did the Treasury ever have a chance to determine what the overall impact of the economy of the United States would be, or ultimately to the Treasury, if we had to do a 6 percent increase, 2-cent increase on first class?

Mr. ROSEBORO. No specific analysis was done on that, sir. But again, I think we can generalize and say it would not be good in terms of the economy, without question. But second, again, I emphasize that we think that it is not a binary decision of raising rates or take this course. We think there are some other options that could be explored, and we are eagerly looking forward to working with you.

Mr. MCHUGH. I understand that. Again, you are playing by the rules that were handed to you. That is not a direct criticism. Let's get to something that may be.

You had mentioned, and Secretary Snow mentioned the allocation of costs are over at 42 percent. Although it is not said directly in the Secretary's testimony, and although you didn't say it directly, I am certainly getting the impression that somehow you feel that is wrong, it ought to be higher.

And you may or may not be right. Maybe it should be 50. Maybe it should be 55. But I am just curious, has the Treasury taken a position that 42 percent is by definition too low, and if so, how did you come to that conclusion?

Mr. ROSEBORO. No, sir, just the opposite. We feel 42 percent is too high. We think from a business perspective an allocated cost should run south of 10 percent as a generality.

Mr. MCHUGH. You are right. I misspoke. I spoke the other way around. But the unallocated costs are too high.

Mr. ROSEBORO. Yes, sir. Absolutely.

Mr. MCHUGH. How, given—I could understand how, and Secretary Snow is certainly a very astute businessman, you could do that in the private sector, but how do you make that determination in the Postal Service? Has a study been done or some kind of data?

Mr. ROSEBORO. From a business perspective, there is no comparison for commercial enterprise not being able to allocate a higher percentage of a cost along product lines. And we think that number could be improved as the Postal Service works to improve systems, whether technical on the MIS side through overall organization. But——

Mr. MCHUGH. I don't mean to interrupt you, but my time is running out. But there is no study, and by the way the Postal Service, I think you would agree, hardly fits the traditional business model. It is a totally different organization.

But be that as it may, you feel—I am interested in how you feel, and that—I am compassionate to your feelings, Mr. Secretary, but that doesn't mean that it is right or wrong.

What I think, and let me ask my final question, if I may indulge the forbearance of the chairman and the other distinguished members, would I be correct in saying, and I would fully support this if it is your view, that the Treasury position is we need to more finely hone the allocation of those costs to ensure that it is distributed accurately. Would that be a fair statement?

Mr. ROSEBORO. Yes, sir.

Mr. MCHUGH. Without prejudging what it ought to be?

Mr. ROSEBORO. Yes, sir. Based on the principle of self-financing, if there going to be adequate self-financing, if that is going to be successful, it goes without saying that proper cost allocation is key to setting appropriate rates.

Mr. MCHUGH. I thank you very much. I fully agree with that. I am glad we were able to clear it up. Thank you, Mr. Chairman.

Chairman TOM DAVIS. Thank you. Ms. Norton.

Ms. NORTON. There is kind of a fictional quality to this hearing, if I may say so. For example, on the veterans benefits, weren't many of those benefits accrued before there was any Postal Service as we know it?

You know, Mr. Roseboro, the notion of holding the Postal Service accountable, with the administration not holding itself accountable, is very interesting to me. So you are offloading veterans benefits, which of course no private corporation would have to pay, but even veteran benefits predating the 1970 formation of the Postal Service, and you think that is a fair way to go at postal reform?

Mr. ROSEBORO. Yes, Congresswoman. Again, in the context of the postal legislation that was passed last year. And again it is very important to look at this as the package and what the package attempted to do. One, it attempted to make the FERS pension funding in the postal equivalent, if you will, to the FERS system, which requires this.

Additionally, again I will emphasize, the dynamic analysis given to the Postal Service has never been done before, and again resulted in, even with the $27 billion obligation to the Postal Service on the military funding, still leaving $21 billion for Treasury taxpayers, a net plus $78 billion. That is not done either in the private sector.

So we think in terms of a package that was more than fair and reflected in the legislation that was passed as a package, and we think in terms of postal reform and moving forward to go back and undo that particular cherry-pick aspect of it is a step backward in postal reform.

Ms. NORTON. Just like you think the escrow is. In other words, accountability all works against the Post Office and in your favor. Let me—I served on, before I came to Congress I served on the Board of three Fortune 500 companies. So when you look at your list of recommendations, they read like the list that any corporation would have, not any corporation about to—that would be in bankruptcy or be out of business if it were in the private sector.

For example, and this is the kind of criticism I have, and why I can't accept the administration's recommendations with a straight

face? I could if you said, for example, in implementing best practices, ensure that the Postal Service's governing body is equipped to meet the responsibilities and objectives of a private enterprise. I take it you mean—of course that is left out—of its size and scope. And it seems to me you should add right there, under best practice, of its size and scope with the obligation to give universal service. Instead you put universal service under accountability, because you are going to make sure that the Postal Service, under the accountability section, has the appropriate oversight to protect consumer welfare and universal mail service.

I just think, you know, you need to sit down with some people in the private sector to figure out how to set your own goals in a more realistic way, and I think you will find, Mr. Roseboro, over here, that whatever was said last year or even this year, Members here in the final context tend to regard ratepayers and taxpayers as interchangeable.

And I have a hard time believing that some of what is proposed here will pass the laugh test here in the Congress if it gets to the floor. For example, just let me—to ask a question about some of the doublespeak that I find in these recommendations.

On top of everything else, about the last thing the Postal Service needs is a complete blow-up or explosion of its labor relations; they are already bad enough. You apparently support collective bargaining, but would establish a three-member board appointed by the President to set compensation. Well, the last time I heard, wages were considered by most employees a central feature to compensation. Are you saying that the Postal Service should have a collective bargaining regimen like that of Federal workers who we do not pretend are a part of the private sector?

Mr. ROSEBORO. Actually, referring to the 35 recommendations from the Commission, as we indicated in the beginning, while we the Commission did a great, admirable job in laying out some prescriptions to perform, we did not support all of the recommendations.

Ms. NORTON. Do you support that recommendation?

Mr. ROSEBORO. We support collective bargaining. We do not support a board to determine compensation.

Ms. NORTON. Do you support continuing bargaining for wages as you do—as the Postal Service does today?

Mr. ROSEBORO. Absolutely.

Chairman TOM DAVIS. Thank you very much, Ms. Norton. Mr. Clay.

Mr. CLAY. Thank you, Mr. Chairman. I appreciate it.

Mr. Potter, let me ask you about—the Postal Service requested $350 million for emergency preparedness for fiscal year 2004, which it did not receive, and $779 million for fiscal year 2005.

I understand the money would help you, the Postal Service, buy and install systems to detect biological agents and poisons and new ventilation and filtration systems in 282 mail handling centers nationwide.

If money is not appropriated for emergency preparedness, will funding for this purpose have to be built into postal rates?

Mr. POTTER. Yes, it will.

Mr. CLAY. Are there any other options other than postal rates?

Mr. POTTER. No. It is either an appropriation or a rate increase.

Mr. CLAY. So again we get back to a tax increase, as the chairman stated.

OK. The President's Commission has recommended rescinding existing regulations that require citizen input before closing plants and small post offices. Rural and urban post offices deemed unprofitable would be closed and future services will be provided on an-ability-to-pay model.

Does this undermine the Service's mission to provide service and access to all communities at uniform rates?

Mr. POTTER. The issue of post offices is one that is very complex. Right now, as you said, there is rules and a comment period. Certainly we would want to have the comment of communities as we look to change our infrastructure. We are not proposing abandoning communities. We are proposing that we deliver services in a different way. For example, we have some post offices in America where people actually have to come and pick up their mail. We might, alternatively, have those folks have their mail delivered closer to their door to a rural mailbox. Those rural carriers are post offices on wheels.

The issue of post offices is very complex. When I think of post offices and post office closings, there are people who are trying to intimate that we would have to close 20,000 of our 38,000 outlets. That is not the case. On one end of the spectrum we have over 2,500 post offices that have less than 200 people living in the area that they serve. We have over 4,500 that have less than 200 deliveries. Now, I certainly think that any good organization should have the ability or the option of exploring how they can deliver services to those communities. But the post office that we all think about, that, you know, serves populations of several thousand people, they are not going to close. We need those facilities to provide delivery services, post office box services, as well as counter services, and I don't envision those closing in my lifetime. But there are those issues out there where we should be able to explore how we can better economically serve communities.

Mr. CLAY. You are absolutely right. It is about efficiency and streamlining of the service. I appreciate your answer.

Mr. Roseboro, perhaps you can answer for Secretary Snow, who stated that the recalculation of postal retirement costs provided the Postal Service with a properly calculated enormous gain of $78 billion at the expense of other CSRS participants. We understood that the Postal Service was on track to overfund its obligations by $78 billion.

Wouldn't that suggest that the Postal Service was in essence supporting the rest of the CSRS participants with its contributions?

Mr. ROSEBORO. The Postal Service was the only CSRS participant that received the benefit of this dynamic analysis. So, in that sense, they benefited.

Mr. CLAY. OK. Well, then—OK, this takes me to the next question then. How can correcting a considerable overpayment be considered a gain for the Postal Service?

Mr. ROSEBORO. I wouldn't characterize it as correcting an overpayment. Again, it was putting it on equal footing with the FERS, the Federal employment retirees system pension setup. That was—

would be a more accurate characterization. And doing that resulted in the $78 billion gain for the Postal Service as well as the obligation to pay the $27 billion portion of the military pension cost.

Mr. CLAY. Well, isn't it true that the $27.9 billion that represents the military cost obligation that has been transferred from Treasury to the Postal Service, $17 billion of this amount is retroactive to 1971 and has already been paid to retirees?

Mr. ROSEBORO. I understand that to be correct, yes.

Mr. CLAY. That is true.

Mr. ROSEBORO. Yes, sir.

Mr. CLAY. OK. Then when they set up in FERS in 1983 wasn't it applied prospectively to individual new hires employed after 1983?

Mr. ROSEBORO. I'm not sure, sir.

Mr. CLAY. You're not sure about it? I believe it was.

Chairman TOM DAVIS. You can get back to us on that. Thank you very much.

Mrs. Maloney.

Mrs. MALONEY. Thank you. I thank the chairman and woman of the respective bodies for holding this important hearing, and I thank all of the panelists for all of your hard work in these difficult times, and I'm very pleased that a New Yorker is at the helm of the postal department, Mr. Potter. We're all very proud of your hard work.

I, first of all, would like to be associated with the comments of my colleague, Mr. Clay, on the need for the Federal Government to fund adequately the Post Office's need for preparedness and Homeland Security concerns that have been piled on with the anthrax threat and, also, the comments of my colleague, Eleanor Holmes Norton, that any reform not weaken collective bargaining or jeopardize the health benefits of our hard-working employees.

I would like to ask Mr. Potter, we now have a freeze on postal rates until 2006; and for the first time, according to GAO, the volume of postal mail has dropped; and some recommend that it may continue to drop. My question is, do you believe that an extension of the current rate freeze would benefit the U.S. Postal Service after 2006?

Mr. POTTER. I believe that the longer we can hold rates stable, the more opportunity we have to grow volume.

Mrs. MALONEY. Well, as you know, in 2006, we will be reviewing the escrow account and how it should be used. What reforms have you put in place to make services available so that the mail can get out at a reasonable rate that benefits all of our residents and all of our businesses?

In addition to representing actually the postal workers who were in the anthrax scare in New York City, I also represent many magazines and publishers; and in the past several years, several have gone out of business—Mademoiselle, Mode, Brill, Business Weekly, a number of very significant magazines. The reason that they state that they went out of business was the increased cost of postal rates. This has the ramification of many workers losing their jobs at a time when over 3 million private sector jobs have been lost in our economy recently. This is very serious.

So what steps are you taking to really run the Post Office more like a business so that our workers are employed with their benefits and that the businesses can afford to employ people, pay taxes and contribute their aspect to the American economy?

Mr. POTTER. First of all, we're working very hard to improve service; and we've done that in every measured category and nonmeasured category as we see complaints down. Customer satisfaction nationally is at an all-times high. Our cost—we have taken $2.7 billion of cost out of our system in the last 2 years. When we put the transformation plan together, we said that we would achieve $5 billion of cost savings out of our bottom line. That's above and beyond the savings that we've had as a result of reduction in volume. So we are very focused on becoming more efficient.

Now, unfortunately, that's meant that we have had fewer employees. So if you talk about unemployment, since I have been Postmaster General—that's less than 3 years—we've reduced our career work force by almost 70,000 people; and I'm not proud of that. I'm proud of the productive improvement, but I wish we had volume so that we could keep everyone gainfully employed. Now we've done that through attrition, and we've worked with our unions and our management associations on that, but we are very, very focused on improving service, reducing costs.

You speak of periodical mailers. We've in the last 3 years introduced automated flat sorters to handle periodical mails; and we've seen our productivity of what we call flat mail—our oversized letters, catalogs, periodicals, magazines—we've seen our productivity double. So we are very much concentrated and working closely with those folks in the periodical industry to improve our productivity and to do the best we can to flatten their rates out.

Mrs. MALONEY. Well, how can the Post Office better adapt to the technological advances that have contributed to the decline in first-class mail?

Mr. POTTER. Well, the best way we can do it is by employing them. We have the most automated postal system in the world. That has helped enable us to reduce our work force and improve our productivity.

We're also reaching out to customers over the Web. We recognize that's a place where people are doing business, and we're working very hard to reach people where they are. We believe that we need to bring our services to the door of every American. After all, we're there every day. We want to bring our services to them at their door, whether it's stamps by mail or other issues. We're focused on growth, and we believe a combination of high levels of service, improved productivity and a focus on growing the business and being customer friendly are the ingredients that will help us be successful in going forward.

Chairman TOM DAVIS. Thank you. Time's up. The gentlelady's time has expired. Thank you very much. If you want to do any followups, I'm sure if you submit them to the panel—be happy to.

[The prepared statement of Hon. Carolyn B. Maloney follows:]

Prepared Statement of Congresswoman Carolyn B. Maloney of New York

before the Special Panel on Postal Reform and Oversight

March 23, 2004

I would like to thank Chairman Tom Davis, Ranking Member Waxman, Chairwoman Collins, Ranking Member Lieberman, Chairman McHugh, and Ranking Member Danny Davis, for holding this important hearing, which gives us a final opportunity to hear from the experts about what kind of postal reform is needed to ensure the long-term viability of the U.S. Postal Service.

We are here again today to discuss the recommendations included in the Report of the President's Commission on the United States Postal Service. The Report contains five principles including the implementation of best practices, transparency, flexibility, accountability, and self-financing.

As we all know, the mailing industry is tremendously vital to our economy, and postal reform is one of the most important issues we will address this year. In fact, today's *Washington Post* reported about the enormous challenges the Postal Service faces including declining mail volume and competition from the Internet, and that unless it is reformed, it faces a very difficult future.

We heard testimony from witnesses in previous hearings about how important postal rates are to the success of their businesses. I represent much of the magazine industry, which is enormously important for the economy of New York and the entire country. Unless the magazine publishers can anticipate postal rates, they will not be able to start new ventures that could employ thousands of workers. At a time when millions of Americans are out of work, we should be protecting the jobs of everyone who relies on the Postal Service for their employment, and we should be working to create new jobs.

We need postal rates that are as low as possible, and we need a mail system that reaches every household across the nation. Any postal reform must take a balanced approach that considers the needs of everyone who depends upon the Postal Service, including the postal employees and the consumers.

All customers, whether they are sending a single letter or millions of magazines, deserve the best service possible from the Postal Service.

I look forward to the testimony, and the opportunity to work with my colleagues on the panel and in the other body in the coming weeks as we draft legislation to reform the Postal Service.

Thank you.

##

Chairman TOM DAVIS. We have one more member, Mr. Duncan, who has joined us. Recognize him for 5 minutes.

But before I do, I want to insert in the record a letter from Grover Norquist, Americans for Tax Reform, to John McHugh; and it notes at the end—it says, "As Congress prepares to address postal reform this year, it seems pension reform might be a good place to start. I urge you to support transferring the military service pension obligation from the USPS back to the Treasury and to allow the USPS to stop overfunding the Civil Service Retirement System."

Without objection, this will be placed in the record.

[The information referred to follows:]

02/24/2004 16:10 FAX 2027850261 AMERICANS FOR TAX REFORM 001/001

AMERICANS FOR TAX REFORM

Grover G. Norquist President

The Honorable John McHugh
Chairman, Special Panel on Postal Reform and Oversight
2333 Rayburn House Office Bldg.
Washington, DC 20515-3223

February 23, 2004

Dear Chairman McHugh:

As you are aware, in 2003 Congress passed the Civil Service Retirement System Funding Reform Act (P.L. 108-18), allowing the United States Postal Service (USPS) to stop overfunding the Civil Service Retirement System (CSRS) through 2005. However, after 2005 all "savings" from this legislation must be placed in an escrow account, thereby offering no permanent relief to the USPS in terms of funding obligations.

The legislation also required the USPS to make payments to the Treasury for the costs of civil service pensions related to military and other government service of postal employees. Under current law, the USPS is the only self-supporting federal agency that is required to pay the costs of military service for its employees. Since the USPS is required to give preference to job applicants with military service under the Veteran's Preference Laws, a hidden tax is imposed on postal ratepayers to subsidize a significant portion of federal obligations. The cost of this obligation alone would total approximately $28 billion.

In late 2003, a study by the Saturation Mailers Coalition (SMC) revealed that as a result of P.L. 108-18, the USPS was on track to subsidize the federal treasury by $150 billion. The report also found that with no further pension reforms, the USPS would need to increase rates by 6% in 2006 just to cover the additional pension obligations. When added to inflationary costs and the USPS' habit of cross-subsidization and unsuccessful business ventures, ratepayers could easily expect to see a double digit rate increase.

As Congress prepares to address postal reform this year, it seems pension reform might be a good place to start. I urge you to support transferring the military service pension obligation from the USPS back to the Treasury, and to allow the USPS to stop overfunding the Civil Service Retirement System.

Onward,

Grover Norquist

1920 L Street NW • Suite 200 • Washington DC 20036
Phone (202) 785-0266 • Fax (202) 785-0261 • www.atr.org

Chairman TOM DAVIS. Gentleman from Tennessee.

Mr. DUNCAN. Thank you, Mr. Chairman. I was here for a few minutes earlier but then had to leave because of some appointments, and I apologize.

But I read this article that—an article that ran a few months ago in the New York Daily News about the Office of the Inspector General of the Postal Service holding conferences where, at one conference in 2001, some staffers wrapped each other from head to toe in toilet paper, aluminum foil, straws and pipe cleaners. At an annual conference in Washington in December 2003, 725 employees went on a treasure hunt to seek clues from costumed actors playing a wizard, magician, dragon, princess and mad scientist. At another annual conference in 2002, employees built tents out of newspapers, hop-scotched across the ballroom on squares, learned scat singing, all these ridiculous things.

They spent millions of dollars doing this. I could—one of the conferences was $1.2 million, one was $1.3 million, one was $1.1 million.

I'm assuming that this type of thing has been cut out or eliminated. But I would like for you to assure me on the record that it has been eliminated and that we're not having conferences of top management at the Postal Service that are going in for these really—they talked about conferences where people—where the employees were asked to hiss like snakes, quack like ducks. I mean, it's just crazy; and they spent millions of dollars doing these things.

Mr. FINEMAN. Congressman, I want to assure you that is not occurring any longer. I want to assure you that when the Board of Governors received complaints about things of this sort, and those articles particularly, we took what were appropriate steps, referred those complaints to the President's Council on Integrity and Efficiency, who did their own investigation—separate investigation on these matters. We were working very closely on the Senate side with Senator Grassley, who had an interest in these matters.

The Inspector General, who was then in charge of these matters, has since resigned; and a new Inspector General has been hired, someone who comes with vast experience in the area. I can assure you that office is being revamped and is now acting in an efficient and appropriate fashion.

Mr. DUNCAN. All right. Thank you very much.

Thank you, Mr. Chairman.

Chairman TOM DAVIS. Thank you very much.

Let me again, Senator Collins, thank you very much for cohosting this with me and Mr. Davis and other Members for being present with us today.

I want to thank our witnesses for taking time from their busy schedules to appear before us.

Committee stands adjourned.

[Whereupon, at 4:43 p.m., the joint committee hearing was adjourned.]

[The prepared statements of Hon. Katherine Harris, Hon. Chris Van Hollen, Hon. Elijah E. Cummings, Hon. Paul E. Kanjorski, and additional information submitted for the hearing record follow:]

~~Congress the~~
Congresswoman
Katherine Harris

March 23, 2004 Submit for the record.

Hearing: Joint Committee Hearing on Principles of Postal Service Reform.

Thank you, Mr. Chairman. I wish to begin by expressing my appreciation for the leadership that you and Chairman Collins, together with Ranking Members Waxman and Lieberman, have demonstrated in seeking a bipartisan solution for this critical problem.

The United States Postal Service remains a cherished institution with a proud history, which is rooted in our constitutional mandate "to establish post offices and post roads." Moreover, the Postal Service continues to maintain its excellent record of service to the American people. Thus, I am proud to lend my support to these efforts to preserve and enhance its legacy.

The postal industry generates **9 billion dollars,** employs **9 million people,** and represents **8 percent** of the gross domestic product. Nevertheless, the antiquated legal mechanism that governs the operations of the Postal Service has placed it at a significant competitive disadvantage.

For example, the dramatic march of technological innovation during the last 3 decades has enabled private delivery companies like Federal Express and UPS to establish on-line bill paying and other conveniences that enhance the appeal of their services in the marketplace. The Postal Service, by contrast, labors under restrictions that prevent it from keeping pace with this intense competition.

Both the Administration and Congress have taken strong steps toward comprehensive reform. By embracing this opportunity to address its critical structural and systemic disadvantages, I believe that we can guarantee the longevity and independence of a truly American institution.

I look forward to the testimony of our witnesses today, and I thank them for their participation.

Hon. Chris Van Hollen
Committee on Government Reform
Joint Senate-House Full Committee Hearing
"The Postal Service in Crisis:
A Joint Senate-House Hearing on Principles for Meaningful Reform"
March 23, 2004 2:30 PM
Room 2154 Rayburn House Office Building

Statement

Mr. Chairman:

Today we gather to discuss an issue of urgent importance to all Americans, reform of a very broken US postal system.

The United States Postal Service has a full-fledged crisis on its hands. Growing debts, declining revenues, increasing prices, under-funded capital projects, and the added potential burden of military benefits portend an increasingly bleak future for the USPS.

Despite the best efforts of many of the people present today, USPS is financially strapped with up to $98 billion in liabilities and obligations that include up to $57 billion in un-funded retiree health benefits.

Last year, House Government Reform Committee leaders on both sides of the aisle joined together to co-sponsor the Postal Civil Service Retirement System Funding Reform Act to provide some financial relief to the USPS by adjusting the calculation of USPS payments to the civil service retirement system.

But in order to gain passage of the bill, USPS was required to accept responsibility for fully funding military benefits—a responsibility previously assumed by the US Department of Treasury and a responsibility that carries a prospective, as well as, retrospective financial burden. If this proposal is permitted to stand, USPS will be virtually the only federal agency required to fully fund military retirement benefits on its own. Such a proposal is unjustified in light of the fact that 90% of USPS military retirees who would receive these benefits completed their active duty service before the USPS even existed.

The President's Commission on Postal Reform recommended that USPS not be required to take on the added financial burden of military retirement benefits saying, "taxpayers, not ratepayers, should finance costs associated with military

service…." Personally, I wonder why the USPS should be charged with the financial responsibility for retirement costs related to service that was totally unrelated to the operations of the USPS?

Ranking Member Waxman attempted to address this problem by amending the CSRS legislation when it was under consideration last year, but was discouraged by the Administration's refusal to accept the legislation without the military benefits requirement in tact.

I look forward today to hearing testimony and participating in a discussion that address this unjustified financial burden on an agency that faces colossal structural, financial and operational challenges in the very near future.

Statement of Congressman Elijah E. Cummings
House Government Reform Committee
"The Postal Service Crisis: A Joint Senate-House Hearing on Principles for Meaningful Reform"
March 23, 2004 at 2:30 p.m.

Thank you, Mr. Chairman for holding this hearing that will allow us to continue our discussion on plans for reform of the United States Postal Service, as well as to address the five principles of reform the President's Commission on the U.S. Postal Service (the Commission) recommended in their report (*Embracing the Future: Making the Tough Choices to Preserve Universal Mail Service*), which was released on July 31, 2003.

Both the Senate and House have conducted several hearings to review the need to modernize our nation's postal laws, and there is no doubt that swift action must be taken to alleviate a future Postal Service crisis. In 2001, the General Accounting Office (GAO) placed the United States Postal Service on its "high risk" list due to the technological challenges it faces, as well as security and terrorism problems. With mail volume declining in fiscal year 2003 for the third year in a row (partly due to technological advances such as email, faxes, and electronic bill payments and correspondence) the Postal Service is in danger of not being able to reign in its rising operation costs.

The United States Postal Service is one of our nation's oldest institutions. Even 200 years after its inception, it continues to deliver over 200 billion pieces of mail a year to approximately 138 million addresses. Because of this, it is important that Congress do everything in its power to ensure this institution's stability so that it might continue to function as the safe and reliable mail system upon which every American relies. The Commission has outlined five principles, which could potentially help to safeguard the U.S. Postal Service from a crisis which include:

- Ensuring that the Postal Service is implementing its best practices;
- Ensuring that information on product costs and performance are available to the public in a timely manner;
- Ensuring that the Postal Service has the authority to reduce costs, set rates, and adjust key aspects of its business;
- Ensuring Postal Service accountability;
- And, lastly, ensuring the financial self-sufficiency of the Postal Service.

It is my hope that this hearing will allow us ample opportunity to address these issues and that it will lead to the implementation of legislation that secures the Postal Service as a viable entity.

With that said, Mr. Speaker, I look forward to hearing from today's witnesses, and once again, thank you Mr. Chairman for holding this hearing.

STATEMENT OF PAUL E. KANJORSKI

BEFORE THE HOUSE GOVERNMENT REFORM COMMITTEE

MARCH 23, 2004

Thank you Chairman Davis and Ranking Member Waxman, I appreciate the opportunity to offer my views on the issue of postal reform, which is currently before the Committee.

As you know, the report of the President's Commission recommends creating a panel similar to the base realignment and closure commission for the purpose of realigning and closing postal distribution facilities. There are several reasons why I feel that some of the recommendations relating to consolidation could be detrimental not only to Northeastern Pennsylvania but also on other parts of the country.

First and foremost, I have concerns that the President's Commission recommendations would erode the United States Postal Service (USPS) delivery and universal service standards. For example, should the USPS decide to consolidate existing distribution facilities in Northeastern Pennsylvania, effective and efficient delivery to the outlying rural areas of the region will become significantly more challenging. Moreover, should the USPS move forward with a proposal to eventually consolidate all of the processing centers in the eastern part of Pennsylvania into a new facility in Philadelphia, maintaining current delivery standards would be more than a challenge – it would simply be impossible. Similar consolidation proposals around the country would likely have comparable effects on rural communities. My concern centers on the potential that the USPS would simply ease current standards in the event of substantial consolidation.

That is why I continue to hold serious reservations that altering the mail distribution process in Northeastern Pennsylvania will result in longer turnaround for mail distribution in our area. My concerns regarding this matter are focused not only on the effect that certain consolidation proposals would have on families in my district, but also on the negative economic impact that reduced delivery standards could have on businesses located in the region.

Economically distressed communities in less populous areas would most likely be disproportionately harmed by consolidation because businesses located in these regions would experience unnecessary delays in receiving their mail. The Committee must, in my view, carefully consider the economic impact of consolidation on communities facing financial difficulties. While major metropolitan areas will likely maintain existing postal processing facilities, economic development efforts in smaller communities could be significantly curtailed should USPS undertake a consolidation plan that ultimately results in a reduction in current delivery standards. Simply stated, businesses located in smaller communities that do not receive their mail in a timely manner will likely leave these communities, thereby exacerbating current economic disparities.

In fact, several businesses in my congressional district would be harmed should consolidation eliminate the mail processing facilities in Northeastern Pennsylvania. For

instance, Sallie Mae has a servicing facility located in my congressional district, which employs nearly 700 people and has an annual mail volume of 27 million pieces and processes $2.4 billion in student loan payments. Sallie Mae has an agreement with the Wilkes-Barre postal facility to receive its mail 365 days a year and receives mail by 3 a.m. daily. Sallie Mae has raised concerns about the possible closure of the Wilkes-Barre postal facility and the negative impact it would have on their ability to process payments. In addition, Sallie Mae has cited the proximity to the postal facilities as one of the reasons why they located their operations in Wilkes-Barre. This is just one of several business that would be negatively impacted by postal consolidation. I am concerned that if this postal facility is closed, businesses such as Sallie Mae will move out of the area and new businesses dependent on the mail will choose to locate in areas with postal facilities nearby. The Committee must, therefore, strive to ensure that delivery standards are maintained as we move forward with our consideration of postal reform matters.

In addition, by creating processing centers that handle mail for a larger area, these facilities will become more attractive targets for terrorist attacks. As you remember, in 2001, letters laced with anthrax were sent to the Senate, resulting in the death of two postal employees and the closure of the Brentwood Postal Facility. A similar shutdown in other major metropolitan areas, most notably in New York City, could have a rippling economic effect that would severely impact companies that rely on the USPS for the delivery of payments, such as the financial services industries and credit card companies.

As a result, when considering consolidation, I believe we must contemplate these possibilities and work to provide secondary facilities that are able to take on extra capacity if another processing center in a major metropolitan area is closed due to terrorist attack. The federal government, through the Securities and Exchange Commission, has encouraged the financial services industry to consider the establishment of back-up facilities outside of the electrical grids and watersheds that service major metropolitan areas. The USPS should consider a similar framework for its processing facilities network.

Our consideration of postal reform legislation should address the threat of terrorist attack on our mail system and should outline a solution to dealing with such an event. Failure to consider how the USPS would operate in the event of a major attack on a metropolitan area could have a devastating affect on our economy, particular given the reliance of most financial services firms on business transactions conducted through postal mail.

Thank you for the opportunity to express my thought and I appreciate your consideration of my remarks.

Post-Hearing Questions for the Record
Submitted to the Honorable John W. Snow
From Senator Susan Collins

"The Postal Service in Crisis: A Joint Senate-House Hearing on Principles for Meaningful Reform"

March 23, 2004

Q. Treasury's testimony includes a discussion on the break-even mandate. Treasury makes the point that analysis of break-even performance should take into account not just accounting results, but also off-balance sheet liabilities and even appropriations. Does the Treasury advocate a new approach to evaluating an appropriate rate base?

A. While the Postal Service's audited financial statements show that is has lost $2.2 billion in the 1972-2003 period, when overlaid with the unfunded liabilities and taxpayer-funded appropriations, the Postal Service has suffered real economic losses in excess of $101 billion.

Unfunded Workers' Comp.	$7.1 billion
Unfunded Post-Retirement Health	60.0 billion
Unfunded Pension Liabilities	5.8 billion
Taxpayer Appropriations	26.4 billion
Accounting Losses (1972-2003)	2.2 billion
Total Economic Losses	**$101.5 billion**

As one of its five principles framing postal reform, the Administration believes that the Postal Service should be self-financing. As such, we believe that ratepayers should be responsible for covering liabilities, including on and off-balance sheet, unfunded liabilities. The unfunded liabilities (pension, post-retirement health care, and workers compensation), that currently amount to about $73 billion, have a lengthy period of time before they come due from a cash perspective. Rather than recouping these expenses immediately, these could be amortized and funded over a rather long period of time. There are opportunities through the long-term amortization of these liabilities combined with meaningful reductions in the Postal Service's expense base (that is envisioned through the accountability of postal management in postal reform) to ease the burden that the full cost of operating the Postal Service places on ratepayers.

Postal reform that is concerned solely with the next rate case is not the kind of reform that the Administration envisioned. It is critical that the Postal Service be self-financing in actuality, not merely in words.

Post-Hearing Questions for the Record
Submitted to the Honorable John E. Potter
From Senator Susan Collins

"The Postal Service in Crisis: A Joint Senate-House Hearing on Principles for Meaningful Reform"

March 23, 2004

1. I understand that the Postal Service has recently implemented a new pay-for-performance system for managerial level employees. In part, the pay plan requires postmasters to meet or exceed a number of "core requirements". How has Postal Headquarters communicated these goals to the managers who will evaluate postmasters? In addition, what tools are postal Headquarters using to train field employees about the implementation of the new pay system?

Response:

Postal Headquarters first introduced the pay for performance program at an in-depth national training conference for all Human Resources (HR) managers at the district and area levels. This training conference provided an overview of measurable indicators at national, unit, and the core requirements levels and further focused on the roles and responsibilities of evaluators during the performance evaluation process. At the conclusion of the conference, every district and area HR office was provided with electronic training aids, handouts, and recommendations for training implementation. The field HR offices then created local training strategies to meet their employee population requirements and implemented the program at the local level using these aids and training materials.

Headquarters officials attend many field implementation meetings all over the country to brief managers and employees on the program. They also attend management association conferences, conventions, and executive board meetings, including the National League of Postmasters, the National Association of Postmasters of the United States, and the National Association of Postal Supervisors, to field issues and clarify concerns that have arisen with the implementation of the program. Postal officials have also conducted interviews on the pay for performance program with these association's presidents, interviews that were later published in the association's publications. As specific concerns have been brought to HR officials' attention, postal officials have worked directly with field counterparts to resolve problems quickly and to ensure that managers are executing the first phases of the pay for performance process correctly as they finalize core requirements and measurable targets.

Headquarters HR officials have set up a national Intranet Website accessible to all non-bargaining unit employees as an information clearinghouse on the pay for performance program and they are in the process of releasing the first of several training videos nationwide to assist evaluators in understanding their roles and responsibilities during the performance evaluation life cycle. The first video is scheduled to be shown this spring.

Headquarters officials continue to solicit input from and partner with each management association as administrative rules are finalized and further training components are deployed to ensure commitment at all levels to make the new pay for performance program successful.

Consumer Alliance for Postal Services
805 15th St, NW, Suite 500
Washington, DC 20005
Telephone 202 289 1776

Testimony of the Honorable Bill Clay before
The joint hearing of
Senate Committee on Governmental Affairs
And
House Special Panel on Postal Reform and Oversight
March 23, 2004

I appreciate the opportunity to provide testimony on the important issue of postal reform on behalf of the Consumer Alliance for Postal Services (CAPS).

To provide a little background on myself, I was a Member of Congress representing the First District of Missouri for 32 years. During that time I had the honor to chair several subcommittees and ultimately the full Committee on Post Office and Civil Service. I do, therefore, have an appreciation of the challenge the Committees face on this issue and welcome the opportunity to share my views of the important questions raised by the Report of the President's Commission on the United State Postal Service.

In light of my long involvement with postal issues and my strong belief in the importance of reliable, affordable mail service, I was pleased to be asked to chair the Consumer Alliance for Postal Services. CAPS was created last year, subsequent to the inception of the Presidential Commission, to monitor postal reform developments and provide a voice for the consumer during the Commission and Congressional deliberations. Our members

represent a wide spectrum of consumers. They include Consumer Action which focuses on the interests of low and moderate income consumers, the National Farmers Union representing over 300,000 farm and ranch families, the National Committee to Preserve Social Security and Medicare which advocates on behalf of older Americans, the AFL-CIO representing workers, the A. Phillip Randolph Institute, the American Diabetes Association and numerous others.

The CAPS mission is to work to insure that the affordable, accessible, and dependable mail service, that all Americans now have and depend upon, is not in any way shortchanged as a result of "postal reform" efforts. The Postal Service is a public service not just another business and we should not lose sight of its essential role in our society. It should operate in the most efficient and cost effective manner achievable while maintaining the current high levels of service and reliability. We do not believe that the American public should have to experience diminished service now or in the future in the name of "right-sizing" or "new business paradigms". We see no looming crisis or emergency that warrant draconian change.

Initially I want to comment on the Presidential Commission report. The report provides a very useful examination of the current state of the Postal Service and outlines a number of changes in operations and structure that are recommended to improve its long-term financial footing. A number of the recommendations would clearly be of benefit and the Committee should weigh carefully their inclusion in legislation. Certainly we support flexible rate setting and allowing the Postal Service management to borrow, invest and

retain earnings. We agree that the Postal Service should not be saddled with the cost of military retirees or forced to escrow funds overpaid to the Civil Service Retirement System Fund.

I must point out, however, the general assessment of my membership is that the Commission's primary interest, certainly reflected in the witnesses it chose to hear, was the concerns of those business entities that are either large volume users of mail service or compete with the Postal Service.

We are concerned that other aspects of the Commission report would, if implemented, prove inimical to the interests of the postal consumer. The Commission proposes that the mission of the Postal Service be redefined to provide "essential" postal services "by the most cost-effective and efficient means possible" at "where appropriate, uniform rates." Who decides what is or is not essential when it comes to mail delivery and how is the notion of cost-effective to be applied to rural, inner city and less affluent communities? Does this mean some are less entitled to universal mail service or that uniform rates for some areas are no longer appropriate? While endorsing the concept of universal service the Commission seems to be opening the door to less than universal service when it is deemed too costly or inconvenient.

The Commission's governance proposals serve to reinforce this concern, in that a framework is being recommended that would obfuscate and thus facilitate decision-making to reduce service and access. CAPS has serious reservations about the so-called corporate style Board of Directors to be appointed by the White House with no input

from Congress **and** is strongly opposed to vesting in a Postal Regulatory Board, totally independent of Congress, the unilateral authority to redefine universal service.

When it comes to the mail what consumers are really concerned about are issues of service and the fair allocation of postal costs.

A point often overlooked is that Americans are very satisfied with the U.S. Postal Service and strongly oppose any efforts to overhaul it. The public opinion survey conducted in May, 2003 on behalf of the Commission found that 75 percent of Americans were satisfied with the reliability of their mail service. When asked about changing the Postal Service, 73 percent felt that the Postal Service works extremely well or would only require minor changes. Of those surveyed, 67 percent oppose changing the Postal Service into a private company independent of government funding or management and 50 percent oppose allowing private companies to sort, process and transport mail. A majority of the respondents cite the hiring of more clerks at post offices as the one change they would like to see.

The Commission apparently did not heed the views of average citizens but was swayed by the parade of mailing industry witnesses who trumpeted outsourcing to the private sector as a panacea. Shifting the work to a low wage, untrained labor force is no panacea but rather a prescription for undermining service and reliability. And there is plenty of evidence that this is the case.

Past efforts to outsource work have proven costly and lowered standards of reliability. In 1997 the Postal Service, after a three-year study aimed at improving delivering times, contracted with a vendor to process and transport Priority Mail. The contract was ended three years later after the contractor tried to charge the Postal Service 40 percent more which resulted in the Postal Service paying over $300 million in termination fees and settlement costs. The Postal Service's Inspector General, in auditing the contract, reported, "Priority Mail processed through the network cost 23 percent more than Priority Mail processed by the Postal Service" and that the vendor "was not meeting overall delivery goals." In addition, the IG report found evidence of abandoned mail and failure to perform required security screenings.

In another instance of private-sector outsourcing, the Postal Service in 1998 engaged a contractor-operated network of Mail Transport Equipment Service Centers to provide vital equipment to supply processing facilities. This project was marked by poor performance and excessive costs. Again, the Postal Service Inspector General issued a highly critical report stating, "the network was not delivering the right equipment at the right time, customers were still not satisfied, employees felt frustrated, and mail operations were still not optimized." The IG estimated cost projections for this undertaking as exceeding in-house operations by $1.1 billion.

These examples argue for caution and prudence before setting in place a framework to largely turn over postal operations to the private sector. The American consumer should

not have to face poor and unreliable service in a quest to achieve perhaps illusory cost savings or to steer lucrative contracts to commercial interests.

Much is being made of the urgent necessity to reduce costs in order to secure a more secure financial future of the Postal Service. From the consumer standpoint it is important to look beyond the rhetoric and examine the cost equation in terms of who is really benefiting and what is really necessary.

While it is only prudent to look to the long-term future of the Postal Service and take steps to assure continued financial stability, there is no present emergency requiring drastic steps. Even with a decline in mail volume, the Postal Service has actually been running a surplus due to gains in productivity, reduced expenses and warranted rate increases. The Postal Civil Service Retirement System Funding Reform Act of 2003 will save the Postal Service $5.5 billion this year and next, thus allowing stable rates at least until 2006.

For the average citizen who uses the Postal Service to pay bills, send birthday cards, and mail the occasional package, costs are modest and present no burden. This is true for even the least affluent. The price of first class postage over time has remained well below increases in the Consumer Price Index. The consumer has no complaint on that score and frankly I doubt many people are troubled by the prospect of a one, two or three cents increase in the price of a stamp.

For the big mailer it is a different story. Postal rates are the lifeblood of that industry and it fights for the biggest discount and the lowest rate. Any means to reduce the overhead and workforce costs of the Postal Service and thus forestall a rate increase is clearly their message.

They don't need the local post office. They aren't worried about their bills getting there on time. They are not interested in having a helpful clerk explain the least expensive way to send a package. They would sacrifice the muscle and bone of our postal system as long as they don't have to pay a penny more to dump their credit card solicitations on the American public.

The big mailers don't want to pay any more and if truth be known, they are not paying a fair share even now. They send first class business mail and bulk advertising mail at heavily discounted postal rates. These rates are given because the mail is pre-sorted but often these discounts exceed the costs the Postal Service avoids by processing pre-sorted mail. There are estimates that the last rate increase could have been one cent less without these unjustified discounts.

The discounted rates mean the Postal Service may be passing substantial costs along to others. It would seem a very apparent first step to help the Postal Service's bottom line would be to insure these large business mailers pay their fair share and that future postal rate increases take into account their obligation to more fully support the postal system that makes their very business possible.

The members of CAPS are committed to preserving universal service. I know the Committee is equally committed to that goal. Our request is simple: that postal reform legislation not undermine in any way the reliable and accessible mail system we now possess. This great nation can afford a great postal system. To settle for anything less is failure.

United States General Accounting Office

GAO

Testimony

Before the Senate Committee on Governmental Affairs and the House Committee on Government Reform

For Release on Delivery
Expected at 2:30 p.m. EST
Tuesday, March 23, 2004

U.S. POSTAL SERVICE

Key Reasons for Postal Reform

Statement for the Record by David M. Walker
Comptroller General of the United States

GAO-04-565T

March 23, 2004

GAO
Accountability·Integrity·Reliability
Highlights

Highlights of GAO-04-565T, a statement for the record for the Senate Committee on Governmental Affairs and the House Committee on Government Reform

U.S. POSTAL SERVICE

Key Reasons for Postal Reform

Why GAO Did This Study

Both the Presidential Commission on the U.S. Postal Service and GAO's past work have reported that universal postal service is at risk and that reform is needed to minimize the risk of a significant taxpayer bailout or dramatic postal rate increases. The administration has also supported comprehensive postal reform.

Recent congressional hearings have highlighted broad consensus on the need for postal reform among diverse stakeholders that include the Postal Service, postal employee organizations, the mailing industry, and Postal Service competitors. GAO has also testified in detail about the need for postal reform.

In light of these developments, GAO was asked to briefly summarize the need for postal reform and elements that should be addressed by postal reform legislation. This statement for the record is based on prior GAO reports and testimonies.

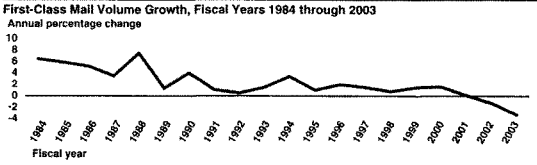
www.gao.gov/cgi-bin/getrpt?GAO-04-565T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Mark Goldstein at (202) 512-2834 or goldsteinm@gao.gov.

What GAO Found

Comprehensive postal reform is urgently needed. The Postal Service's financial viability is at risk because its business model—which relies on mail volume growth to cover the costs of its expanding delivery network—is not aligned with 21st century realities. Financial, operational, governance, and human capital challenges threaten the Service's ability to remain self-supporting while providing affordable, high-quality, and universal postal service. Key trends that demonstrate the need for reform include declining mail volume, particularly for First-Class Mail; changes in the mail mix from high-margin to lower-margin products; increased competition from private delivery companies; and subpar revenue growth. Moreover, the Service continues to have significant financial liabilities and obligations (e.g., retiree health obligations), uncertain funding for emergency preparedness, challenges to achieving sufficient cost-cutting, renewed difficulties in substantially improving postal productivity, and uncertainties regarding the adequacy of capital investment. Thus, the Service's transformation efforts and financial outlook continue to be on GAO's High-Risk List.

First-Class Mail Volume Growth, Fiscal Years 1984 through 2003



Source: Postal Service.

The Postal Service is taking actions within its existing authority to make incremental progress toward transformation, but these steps cannot resolve the fundamental issues associated with the Service's current business model. To avoid the risk of a significant taxpayer bailout or dramatic increases in postal rates, Congress should enact comprehensive postal reform legislation that addresses the Service's key structural and systemic deficiencies, including its unfunded obligation for retiree health benefits and the escrow requirement. It is important that Congress act before the Service faces a crisis that could limit congressional options, particularly because it will take time for the Service to implement major changes.

In GAO's view, specific elements of comprehensive postal reform legislation should address the following: clarify the Service's mission and role; enhance the Service's governance, transparency, and accountability; improve flexibilities and oversight; and make needed human capital reforms.

Chairman Collins, Chairman Davis, and Members of the Committees:

We are pleased to have the opportunity to comment on the need for postal reform and elements that should be addressed by postal reform legislation. This statement is based on our prior work.[1] First, comprehensive postal reform is urgently needed. The Postal Service's financial viability is at risk because its business model—which relies on mail volume growth to cover the costs of its expanding delivery network—is not aligned with 21st century realities. Financial, operational, governance, and human capital challenges threaten the Service's ability to remain self-supporting while providing affordable, high-quality, and universal postal service. Thus, the Service's transformation efforts and financial outlook continue to be on our High-Risk List. Second, specific elements of comprehensive postal reform legislation should address the following: clarify the Service's mission and role; enhance the Service's governance, transparency, and accountability; improve flexibilities and oversight; and make needed human capital reforms.

The Need for Postal Reform

The Postal Service is taking actions within its existing authority to make incremental progress toward transformation, but these steps cannot resolve the fundamental issues associated with the Service's current business model. To avoid the risk of a significant taxpayer bailout or dramatic increases in postal rates, Congress should enact comprehensive postal reform legislation that addresses the Service's key structural and systemic deficiencies, including its unfunded obligation for retiree health benefits and the escrow requirement established by P.L. 108-18.[2] It is important that Congress act before the Service faces a crisis that could limit congressional options, particularly because it will take time for the Service to implement major changes. The following key trends demonstrate that postal reform legislation is needed:

[1]See U.S. General Accounting Office, *Need for Comprehensive Postal Reform*, GAO-04-455R (Washington, D.C.: Feb. 6, 2004); *U.S. Postal Service: Key Elements of Comprehensive Postal Reform*, GAO-04-397T (Washington, D.C.: Jan. 28, 2004); *U.S. Postal Service: Bold Action Needed to Continue Progress on Postal Transformation*, GAO-04-108T (Washington, D.C.: Nov. 5, 2003).

[2]The Postal Civil Service Retirement System Funding Reform Act of 2003 (P.L. 108-18), enacted in April 2003, required that, beginning in fiscal year 2006, the difference between the Service's contributions under new and old funding methods—the "savings"—be held in an escrow account until the law is changed.

- *Declining mail volume:* Total mail volume declined in fiscal year 2003 for the third year in a row—a historical first for the Service, which has depended on rising mail volume to help cover rising costs and mitigate rate increases. First-Class Mail volume declined by a record 3.2 percent in fiscal year 2003 and is projected to decline annually for the foreseeable future as customers increase their use of electronic alternatives for communications and payments. This trend is particularly significant because First-Class Mail covers more than two-thirds of the Service's institutional costs.

- *Changes in the mail mix:* The Service's mail mix is changing as the volume for high-margin products, such as First-Class Mail, declines and the volume of lower-margin products, such as some types of Standard Mail, increases. These changes reduce the revenues available to cover the Service's institutional costs.

- *Increased competition from private delivery companies:* Private delivery companies dominate the market for parcels greater than 2 pounds and appear to be making inroads into the market for small parcels. Once a highly profitable growth product for the Service, Priority Mail volume is declining as the highly competitive parcel market turns to lower-priced ground shipment alternatives. Priority Mail volume fell 13.9 percent in fiscal year 2003 and has declined nearly 30 percent during the last 3 years. Express Mail volume is also declining for the same reason. In addition, United Parcel Service (UPS) and FedEx have established national retail networks through UPS's acquisition of MailBoxes Etc., now called UPS Stores, and FedEx's recent acquisition of Kinko's.

- *Subpar revenue growth:* The Service's revenues are budgeted for zero growth in fiscal year 2004, which would be the first year since postal reorganization that postal revenues have failed to increase. However, as the Service has recognized, even this target will be a challenging one. In the absence of revenue growth generated by increasing volume, the Service must rely more heavily on rate increases to cover rising costs and help finance capital investment needs.

- *Significant financial liabilities and obligations:* Despite the passage of legislation that reduced the Service's pension obligations, the Service has about $88 billion to $98 billion in liabilities and obligations, including $47 billion to $57 billion in unfunded retiree health benefits. Under the current pay-as-you-go system, the Service may have difficulty financing its retiree health benefits obligation in the future if mail volume trends continue to

affect revenues while costs continue to rise. The Service has recently proposed two options to Congress so the Service can begin to prefund this obligation to the extent that it is financially able.

- *Uncertain funding for emergency preparedness:* The Service requested $350 million for emergency preparedness for fiscal year 2004, which it did not receive, and $779 million for fiscal year 2005. If no funds are appropriated, such funding may have to be built into postal rates.
- *Challenges to achieve sufficient cost-cutting:* The Service achieved additional cost-cutting to compensate for below-budget revenues in fiscal year 2003. Despite this progress, in the longer term it is unclear whether continued cost-cutting efforts can offset declines in First-Class Mail volume without affecting the quality of service.
- *Renewed difficulties in substantially improving postal productivity:* The Service's productivity increased by 1.8 percent in fiscal year 2003 but is budgeted to increase by only 0.4 percent in fiscal year 2004. In the absence of mail volume growth, substantial productivity increases will be required to help cover cost increases generated by rising wages and benefit costs and to mitigate rate increases.
- *Uncertainties regarding the adequacy of capital investment:* The Service's capital cash outlays declined from $3.3 billion in fiscal year 2000 to $1.3 billion in fiscal year 2003, which was the lowest level since fiscal year 1986. Looking forward, it is unclear what the Service's needs will be for maintaining and modernizing its physical infrastructure, as well as whether its plans for capital investment will be adequate for transformation.

Key Areas for Postal Reform

Key areas of the Service's statutory framework that need to be addressed include:

- *Mission and Role:* Congress needs to (1) define the scope of universal service and the postal monopoly and (2) clarify the Service's role with regard to competition and regulation.
- *Governance, Transparency, and Accountability:* Congress should (1) delineate public policy, operational, and regulatory responsibilities; (2) ensure managerial accountability through a strong, well-qualified corporate-style board that holds its officers responsible and accountable

for achieving real results; and (3) define appropriate reporting mechanisms to enhance the Service's transparency and accountability for financial and performance results.

- *Flexibility and Oversight:* Congress needs to balance increased flexibility for the Service—through streamlining the rate-setting process and allowing a certain amount of retained earnings—with appropriate oversight by an independent regulatory body to protect postal customers against undue discrimination, restrict cross-subsidies, and ensure due process. In addition, the Service needs additional flexibility to rationalize its infrastructure and reshape its workforce. Any such additional flexibility should be accompanied by appropriate safeguards to prevent abuse, along with mechanisms for enhanced transparency and accountability.

- *Human capital reforms:* Congress needs to (1) determine the Service's responsibility for pension costs related to military service, funding retiree health benefits, and determine what action to take on the escrow account established in recent pension legislation; (2) decide whether postal workers' compensation benefits should be on par with those in the private sector; and (3) clarify pay comparability standards.

Contact and Acknowledgments

For further information regarding this statement, please contact Mark L. Goldstein, Director, Physical Infrastructure Issues, at (202) 512-2834 or at goldsteinm@gao.gov. Individuals making key contributions to this statement included Teresa Anderson, Gerald P. Barnes, Margaret Cigno, Kathleen A. Gilhooly, and Kenneth E. John.

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Comptroller General
of the United States

United States General Accounting Office
Washington, DC 20548

February 6, 2004

The Honorable Susan M. Collins
Chairman, Committee on
Governmental Affairs
United States Senate

Subject: *Need for Comprehensive Postal Reform*

Dear Chairman Collins:

This letter responds to your request for our views on the need for postal reform and is based upon our prior testimonies related to this issue.[1] In summary, we believe that comprehensive postal reform is urgently needed. The ability of the Service to remain financially viable is at risk because its current business model—which relies on mail volume growth to cover the costs of its expanding delivery network—is not well aligned with 21st century realities. Since we placed the Postal Service's transformation efforts and financial outlook on our High-Risk List in April 2001, I have testified on several occasions about the governance, financial, operational, and human capital challenges that threaten the Service's ability to carry out its mission. If not effectively addressed in a timely manner, these challenges serve to threaten the Service's ability to remain self-supporting while providing affordable, high-quality, and universal postal services to all Americans.

The following key trends serve to reinforce our view that enactment of postal reform legislation is needed:

- *Declining mail volume*: Total mail volume declined in fiscal year 2003 for the third year in a row—a historical first for the Service, which has depended on rising mail volume to help cover rising costs and mitigate rate increases. First-Class Mail volume declined by a record 3.2 percent in fiscal year 2003 and is projected to decline annually for the foreseeable future. Some of this decline is due to technology advances (e.g. E-mail, digital phones, faxes, and electronic bill payments) that are likely to increase in the future. This trend is particularly significant because First-Class Mail covers more than two-thirds of the Service's institutional costs.

[1] See U.S. General Accounting Office, *U.S. Postal Service: Bold Action Needed to Continue Progress on Postal Transformation*, GAO-04-108T (Washington, D.C.: Nov. 5, 2003); and *U.S. Postal Service: Key Elements of Comprehensive Postal Reform*, GAO-04-397T (Washington, D.C.: Jan.28, 2004).

- *Changes in the mail mix*: The Service's mail mix is changing with declining volume for high-margin products, such as First-Class Mail, and increasing volume of lower-margin products, such as some types of Standard Mail. These changes reduce revenues available to cover the Service's institutional costs.

- *Increased competition from private delivery companies*: Private delivery companies dominate the market for parcels greater than 2 pounds and appear to be making inroads into the market for small parcels. Priority Mail volume fell 13.9 percent in fiscal year 2003 and over the last 3 years has declined nearly 30 percent. Once a highly profitable growth product for the Service, Priority Mail volume is declining as the highly competitive parcel market turns to lower-priced ground shipment alternatives. Express Mail volume is declining for the same reason. In addition, United Parcel Service (UPS) and FedEx have established national retail networks through UPS's acquisition of MailBoxes Etc., now called UPS Stores, and FedEx's recent acquisition of Kinko's.

- *Subpar revenue growth*: The Service's revenues are budgeted for zero growth in fiscal year 2004, which would be the first year since postal reorganization that postal revenues have failed to increase. However, as the Service has recognized, even the zero-growth target will be challenging. In the absence of revenue growth generated by increasing volume, the Service must rely more heavily on rate increases to cover rising costs and help finance capital investment needs.

- *Declining capital investment*: The Service's capital cash outlays declined from $3.3 billion in fiscal year 2000 to $1.3 billion in fiscal year 2003, which was the lowest level since fiscal year 1986, and far below the level of the late 1990s, when the Service spent more than $3 billion annually. Capital cash outlays are budgeted to increase to $2.4 billion in fiscal year 2004, but this level may not be sufficient to enable the Service to fully fund its capital investment needs. In the longer term, it is unclear what the Service's needs will be to maintain and modernize its physical infrastructure, as well as how these needs will be funded.

- *Renewed difficulties in substantially improving postal productivity*: The Service's productivity increased by 1.8 percent in fiscal year 2003 but is estimated to increase by only 0.4 percent in fiscal year 2004. In the absence of mail volume growth, substantial productivity increases will be required to help cover cost increases generated by rising wages and benefit costs and to mitigate rate increases.

- *Significant financial liabilities and obligations*: Despite the passage of legislation that reduced the Service's pension obligations, the Service has about $88 billion to $98 billion in liabilities and obligations that include $47 billion to $57 billion in unfunded retiree health benefits. Under the current pay-as-you-go system, the Service may have difficulty financing its retiree health benefits obligation in the future if mail volume trends continue to impact revenues while costs in this area continue to rise. The Service has recently proposed two options to Congress, so the Service could prefund this obligation to the extent that it is financially able.

- *Uncertain funding for emergency preparedness*: The Service requested $350 million for emergency preparedness for fiscal year 2004, which it did not receive, and $779 million for fiscal year 2005. If the money is not appropriated, funding for this purpose may have to be built into postal rates.

- *Challenges to achieve sufficient cost cutting*: The Service achieved additional cost cutting to compensate for below-budget revenues in fiscal year 2003. Despite this progress, in the longer term it is unclear whether continued cost-cutting efforts can offset declines in First-Class Mail volume without impacting the quality of service.

Although we have discussed numerous actions that the Postal Service can take within its existing authority to improve its overall efficiency and effectiveness, we do not believe that incremental steps toward postal transformation can resolve the fundamental and systemic issues associated with the Service's current business model. To avoid the risk of a significant taxpayer bailout or dramatic postal rate increases, we believe that Congress should enact comprehensive postal reform legislation that includes the Service's overall statutory framework, resolution of issues regarding the Service's pension and retiree health benefits obligations, and whether there is a continued need for an escrow account.

The key areas of the Service's statutory framework that need to be addressed include:

- *clarifying the Service's mission and role* by defining the scope of universal service and the postal monopoly and by clarifying the role of the Service in regard to competition and its regulatory functions;

- *enhancing governance, transparency, and accountability* by delineating public policy, operational, and regulatory responsibilities; by ensuring managerial accountability through a strong, well-qualified corporate-style board that holds its officers responsible and accountable for achieving real results; and by defining appropriate reporting mechanisms to enhance the Service's transparency and accountability for financial and performance results;

- *improving flexibilities and oversight* by balancing increased flexibility for the Service— through streamlining the rate-setting process and allowing a certain amount of retained earnings—with appropriate oversight by an independent regulatory body to protect postal customers against undue discrimination, to restrict cross-subsidies, and to ensure due process. In addition, the Service needs additional flexibility to rationalize its infrastructure and reshape its workforce. Any such additional flexibility should be accompanied by appropriate safeguards to prevent abuse along with enhanced transparency and accountability mechanisms; and

- *making needed human capital reforms* such as (1) determining the Service's responsibility for pension costs related to military service, funding retiree health benefits, and determining what action to take on the escrow account established in recent pension legislation; (2) deciding whether postal workers' compensation

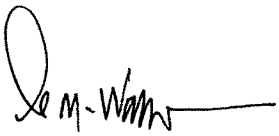
benefits should be on par with those in the private sector; and (3) clarifying pay comparability standards.

We believe that Congress now has a rare opportunity to assure the Service's long-term financial viability through comprehensive postal reform legislation that addresses the Service's key structural and systemic deficiencies, its unfunded obligations, including its retiree health benefits obligation, and the escrow requirement. Key legislative and administrative actions in connection with transforming the Postal Service can also serve as positive examples for other key government transformation efforts.

As agreed with your office, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the date of this letter. At that time, we will provide copies to interested congressional committees. We will also make copies available to others on request. In addition, the report will be available at no charge on the GAO Web site at http://www.gao.gov.

For additional information about this report, please contact Mark L. Goldstein, Director, Physical Infrastructure Issues at (202) 512-2834 or at goldsteinm@gao.gov. Please contact me if I can be of any further assistance to help make comprehensive postal reform a reality.

Sincerely yours,



David M. Walker
Comptroller General
of the United States

(543095)

U.S. Senate
Committee on Governmental Affairs

&

U.S. House of Representatives
Committee on Government Reform

Joint Hearings
on
The Postal Service in Crisis:
A Joint Senate-House Hearing on
Principles for Meaningful Reform
March 23, 2004

Statement of
Diane J. Elmer
Vice-President – Delivery Logistics
Cox Target Media, Inc.
(Valpak Direct Marketing Systems, Inc.)
8605 Largo Lakes Drive
Largo, Florida 33773-4910

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Stat m nt f Diane J. Elm r, Vice President – Delivery Logistics
Cox Target Media, Inc. (Valpak Direct Marketing Systems, Inc.)
March 23, 2004

EXECUTIVE SUMMARY

Postal reform legislation to implement the principal recommendations of the President's Commission on the United States Postal Service is needed. The Postal Service must have broad discretion to manage its own business. This managerial freedom must include both the ability to modernize and improve its plants and facilities, and the ability to close antiquated or underutilized facilities.

However, Valpak rejects the notion that the principal problem faced by the Postal Service is that it does not have the unilateral authority to set its own rates, either for competitive products or for all products. So long as the Postal Service benefits from a statutory monopoly and governmental status, it makes no sense that it should have broad authority to set its own rates for any products.

The Postal Rate Commission ("PRC") was created so that postal rates and fees would be set by a disinterested body with technical expertise. An adversarial hearing process forces the Postal Service to prove its case on the record in a proceeding that is open to any mailer. Generally, the PRC does a very good job in evaluating technical evidence establishing the cost of each postal product, and setting postal rates.

Also, the PRC ratemaking process has had several important secondary benefits for the Postal Service and mailers, such as increasing transparency, helping the Postal Service learn more about its own costs, advancing innovation and worksharing, and correcting errors.

Several criticisms of the current ratemaking process do not withstand scrutiny. The statutory process for omnibus rate cases is neither too long nor too expensive, and clearly is not the problem. Efforts to cut short the ratemaking process would result in the reduction of the procedural due process rights of mailers. The cost of the ratemaking process is small when compared to the importance of the matters at issue.

Moreover, the Postal Service has the ability to control the complexity of omnibus rate cases, and has chosen to litigate within the context of those cases a variety of issues that could be decided in other types of cases, such as complex costing issues and classification issues. If these issues were decided in other PRC dockets between omnibus rate cases, those cases could be

handled easily within as little as five months. In truth, if the Postal Service were given the tools to contain its costs, a rate case would be needed probably only once every four or five years, and the existing rate-setting procedure would become a non-issue. Conversely, if the Postal Service proves unable to contain its costs, then any attempt to improve matters by simply reforming the rate-setting mechanism will be misdirected and almost surely will be in vain.

Allowing the Postal Service to set its own rates also would appear to eliminate the ability of mailers to seek review in federal court of those rates for being arbitrary or capricious. Proposals for Postal Service pricing flexibility would not require the Postal Service to act based on record evidence, but rather would grant broad authority, which likely would be unreviewable by any court, even if their decisions on rates were arbitrary or capricious.

The principal aspect of the ratemaking process that needs to be addressed by Congress is the elimination of the authority of the Governors of the Postal Service to modify PRC-approved rates under certain circumstances. Most recently utilized by the Governors in PRC Docket No. R2000-1, this power allows a governmental monopoly the right to trump the recommendations of the PRC, and thus effectively invalidate the entire ratemaking process. We urge the repeal of this curious provision in the law, as proposed in H.R. 4970 (2002).

The suggestion by some — that PRC review rates after they have been set by the Postal Service should replace the current system for some or all postal products — would not work. Proper ratemaking cannot depend on the possibility that a particular mailer or mailer association will invest the funds necessary to unearth hidden problems in costing and ratemaking underlying USPS-set rates and then initiate a complaint proceeding with the PRC. Moreover, the history of the current complaint process at the PRC demonstrates the problems inherent in such an approach to ratemaking.

Postal reform should center around giving the Postal Service the tools necessary to do its job in the proper management of the Postal Service, but one of those tools is not the unilateral authority to set its own rates. So long as the Postal Service has any monopoly protection and government status, those powers must be vested in an independent body which decides such matters in the light of day, based on record evidence.

(Note: The complete testimony appears at http://www.valpak.com/info/corporate/press_releases/press_releases_content.jsp.)

INTRODUCTION

Thank you for the opportunity to present to the Committee the statement of Cox Target Media, Inc., Valpak Direct Marketing Systems, Inc., and Valpak Dealers' Association, Inc. ("Valpak") with respect to pending postal reform legislation.

Valpak Direct Marketing Systems, Inc.
Valpak Dealers' Association, Inc.

Valpak Direct Marketing Systems, Inc. is a wholly-owned subsidiary of Cox Target Media, Inc., and is a substantial mailer, primarily using Standard Mail. Valpak is the nation's largest firm in the subset of the hard-copy, cooperative direct mail advertising industry which is sometimes referred to as "coupons in an envelope."

Valpak operates throughout the United States through approximately 190 franchisees which are members of the Valpak Dealers' Association, Inc. The work of these franchisees is supplemented by efforts of approximately 1,200 sales representatives.

Valpak's headquarters are located in Largo, Florida. Valpak also prints at, and mails from, a large facility in Elm City, North Carolina. Valpak mails over 500 million pieces annually.

Our business is enormously reliant on the United States Postal Service ("USPS"). We have earnestly and consistently supported the Postal Service in carrying out its basic mission — to deliver the mail, rapidly and economically.

We need and want the Postal Service's delivery business to thrive and prosper in coming years.

Valpak has been an active intervenor before the Postal Rate Commission ("PRC") in numerous recent cases, including the following dockets:

- Docket No. MC95-1, the broad reclassification case which created Standard ECR mail;
- Docket No. R97-1, an omnibus rate case;
- Docket No. R2000-1,the last omnibus rate case which was litigated fully;
- Docket No. R2001-1, the last omnibus rate case which was settled;
- Docket No. MC2002-2, the precedent-setting Capital One Services, Inc., negotiated service agreement ("NSA") case; and
- Docket No. RM2003-5, the rulemaking docket which set up rules for the consideration of NSAs.

Valpak Prior Statements on Postal Reform

Over the years, Valpak has offered its views on a variety of postal policy issues. It is because of Valpak's need for — and belief in — the Postal Service that we have been willing to advance constructive criticism when we felt it necessary. For example, in July 1997, Valpak filed comments with the Board of Governors of the Postal Service urging levels of capital investment higher than those contained in the Postal Service's Five-Year Strategic Plan.

Just over five years ago, Cox Target Media, Inc. President and CEO William B. Disbrow filed testimony on H.R. 22 ("The Postal Modernization Act of

1999") before the Subcommittee on the Postal Service of the House Committee on Government Reform (March 4, 1999). This testimony was focused on somewhat different proposed legislation, but the principles that we have tried to articulate have stayed the same over the years, as follows:

> 1. The need to upgrade plant and equipment, constantly improving the infrastructure of the Postal Service.
>
> 2. The need to increase Postal Service capital investment, even if debt cannot be paid down as quickly.
>
> 3. The need for increases in research and development spending by the Postal Service.
>
> 4. The need to refocus the Postal Service on increasing productivity, and ensuring that any rate cap formula would include a productivity factor.
>
> 5. Require that noncompetitive products pay a fair share of the Postal Service's institutional costs.
>
> 6. Allowing Postal Service management broad latitude to carry out its traditional mission to deliver the mail, while preventing the Postal Service from abusing its monopoly and governmental status in competition with the private sector.

Valpak filed three sets of comments with the President's Commission on the United States Postal Service:

- Statement of William B. Disbrow, February 12, 2003
- Rebuttal Comments of William B. Disbrow, March 13, 2003
- Final Comments of William J. Olson, Esquire, July 8, 2003

Lastly, Valpak addressed several of the President's Commission recommendations in testimony filed with the Senate Committee on Governmental Affairs on November 19, 2003, making the following points:

1. Mission — "Stick to Its Knitting." The Postal Service should focus on delivery of traditional mail, leaving electronic products and services to a well-served and innovative private marketplace.

2. Rate Setting — Role of Postal Rate Commission/Postal Regulatory Board. Valpak is not opposed to efforts to improve the rate-setting process, but believes that this is one aspect of the postal world that generally works well now. Before adopting changes in the rate-setting process, the Committee should review carefully the serious and unaddressed problems inherent in the "price cap" alternative recommended by the President's Commission, as explained in Comptroller General Walker's testimony before the Senate Committee on Governmental Affairs on November 5, 2003, at pages 27-28. The Postal Service cannot be entrusted with setting rates unilaterally. A strong, independent Postal Rate Commission/ Postal Regulatory Board is needed.

3. Negotiated Service Agreements. Valpak believes that Negotiated Service Agreements should be reserved for circumstances that are truly unique. Most NSAs discussed to date would be better implemented through niche classifications, as currently authorized under existing laws.

4. Closing Facilities — Postal Network Optimization Commission ("P-NOC"). Valpak strongly supports the recommendations in the report of the President's Commission, and in the corresponding provisions in the Carper bill, S. 1285, that deal with closing unneeded postal facilities.

5. Standardizing and Modernizing Facilities via Debt Financing. Valpak supports the President's Commission recommendations that would have the Postal Service eliminate costly and obsolete postal facilities. Further, Valpak proposes that the Postal Service's debt limit be tripled, or at least increased substantially, to enable and facilitate the requisite modernization and standardization of the mail processing network within the next decade or so.

6. Promotion of Worksharing. Valpak supports additional worksharing within the context of the existing ratemaking system.

It does not believe that after-the-fact review by regulators, triggered by complaints, will work as well as the current system.

Overview of Postal Reform

Valpak appreciates the time the Senate Committee on Governmental Affairs and the House Committee on Government Reform have spent in investigating the problem and developing legislative changes which are necessary to assist the Postal Service to modernize, so that it can better face a variety of marketing and operational challenges.

In general, Valpak supports the recommendations by the President's Commission that are intended to improve the Postal Service in performing its core mission. We believe the Postal Service should have broad discretion to manage its business, but so long as it has a monopoly over letters and the myriad other benefits that flow from governmental status, it cannot be invested with ratemaking authority. Improvements in ratemaking can and should be made, but the Postal Service simply cannot be allowed to act alone to set its own rates, or determine its own product offerings.

As a result, we are concerned that many of the proposals for so-called reform of the ratemaking process, through what is vaguely described by many as "pricing flexibility," would be detrimental to the mailing community. It appears that some mailers have given inadequate thought to how they could be adversely affected if the Postal Service had such "pricing flexibility."

Most of the criticisms of the ratemaking process that have been made are simply not valid. Complaints about the time and expense of litigation are vastly overblown. In some cases, criticisms have been made by mailers who have been unable to justify the type of rates that they want to pay through the PRC litigation process, and now want to change the rules of the game, hoping they will get a better outcome in direct dealings with the Postal Service.

We believe that reliance on a monopoly to set its own rates for any of its own products is fraught with danger — certainly for the mailers, but also for the Postal Service and the public. It could result in the Postal Service implementing sweeping changes on relatively short notice. And, in view of the Postal Service's monopoly, mailers in the non-competitive classes would have little recourse other than a complaint procedure, and the existing complaint procedure has proven weak and ineffective.

If the existing PRC-review process were to be abolished, the principal recourse for disgruntled mailers would be to seek redress from arbitrary Postal Service decision-making by petitioning Congress. Such an eventuality would tend to re-politicize the entire process, and would be a giant step backwards.

Currently, cases litigated before the Postal Rate Commission can be appealed to a U.S. Courts of Appeals, and the PRC must act on the record, and is subject to being overturned for actions which are arbitrary or capricious. If the Governors are given power to set rates, without a record, it would appear

that their rates would be unreviewable by any federal court, even if they were arbitrary or capricious.

We agree with the comments of Gary Pruitt of the Newspaper Association of America, who submitted testimony to the Senate Committee on Governmental Affairs on March 11, 2004, when he said about the Postal Service:

> [w]ith this unique size and privilege come responsibilities, including limitations on the flexibility with which the Postal Service prices its services. For good reason the Congress has never granted the Postal Service both a legal monopoly and pricing freedoms....
>
> Accordingly, we are more cautious towards giving the Postal Service more pricing freedom. As a public service provided by the federal government, the Postal Service simply should not have the same pricing freedom as a private company.

We would rather see ratemaking for all postal products continue to be placed in the hands of an independent body which does not have a vested interest (except the public interest) in the rates being set. None of the proposals presented to date to give the Postal Service greater ratemaking power makes sense to us.

This statement is lengthy, but sometimes it takes time to reveal the pitfalls underlying a catchy slogan (*e.g.*, "pricing flexibility") or to refute an accusation (*e.g.*, "ratemaking takes too long").

These and other issues are discussed in the following five sections of testimony.

I. Understanding the Current Regulatory Process

II. The Time and Cost of Litigating Rate Cases Could Be Reduced Without Legislation

III. The Importance of Proper Pricing for Worksharing

IV. Inadequacy of Post-Rate Review

V. Principles for Meaningful Postal Reform

I. UNDERSTANDING THE CURRENT REGULATORY PROCESS

In each omnibus rate case, the Postal Reorganization Act of 1971 ("the Act") requires the PRC to recommend a set of rates that will generate revenues sufficient to cover anticipated costs and therefore satisfy the statutory break-even requirement. If the revenue generated by any class of mail were reduced, offsetting revenue must be recovered from other classes. This necessity, to recover the Postal Service's revenue requirement from mailers, causes the ratemaking process to be described by many, including the PRC, as a "zero-sum game."

The "zero-sum" description also has been used to pejoratively describe the entire ratemaking process, making it appear to be an exercise in futility, having no value in and of itself. In Valpak's view, however, that is not correct. Of course, it is this ratemaking process that determines whether postal costs

have been tracked accurately, and whether rates are being set in accordance with statutory criteria. This it does quite well. But there are secondary benefits, often overlooked, which also make the current ratemaking process important to retain. The current process has commendable features, described broadly as:

A. Transparency;

B. Learning and improvement;

C. Innovation/worksharing; and

D. Correction of errors.

A. Transparency

When the Postal Service submits a request for rate increases, it must explain and justify its rate proposals. It is required to furnish information on volumes, cost levels, productivities, and mechanization plans to the public. It also must provide detailed analyses of its operations. The Postal Service must respond to interrogatories and document requests from both mailers and the PRC. The Postal Service must defend its request in an adversarial process. The assembled evidence forms a public record, which then is used for setting rates. But the value of this public record is not limited to setting rates. Mailers, mailer organizations, government entities such as the General Accounting Office ("GAO"), and others use information on the record to analyze cost trends, productivity achievements, and other aspects of organizational

effectiveness. Given the closeness with which information generally is held by the Postal Service, without this public proceeding, and without the PRC's power to order compliance with discovery requests, it is likely that the Postal Service would release only a tiny fraction of the information now available.

B. Learning and Improvement

Using that public evidentiary record, mailers and others perform analyses of perceived problems and then, in a variety of ways, put pressure on the Postal Service to remedy problems that exist, which it otherwise had ignored or likely would ignore. Many important improvements of the Postal Service, resulting in lower costs for all mailers, have resulted from the ratemaking process. Often the issues are technical, but have real and beneficial consequences for mailers. Here are just a few recent examples:

1. Nonproductive time. In Docket No. R90-1, certain mailers focused on trends in the amount of nonproductive idle time of postal employees. The Postal Service had not focused internally on these trends or on their magnitude. The PRC highlighted these trends and recommended that they be investigated. After the case, these trends began receiving attention in labor negotiations. There is every reason to believe that the efficiency of the Postal Service was improved by this outside scrutiny.

2. Data quality study. Following Docket No. R97-1, and based on questions raised in that and prior cases, the PRC was instrumental in getting

GAO and the Postal Service to sponsor jointly with it an independent Data Quality Study. Completed in April 1999, this study provided meaningful guidance on costing. In a letter to Congressman McHugh, the Postmaster General wrote: "The *Data Quality Study* is the most comprehensive review, outside of PRC proceedings, ever conducted of the Postal Service's rate making data."

3. Study of non-sampling error. Following up on an issue omitted from the Data Quality Study, the PRC urged the Postal Service to study the effects of non-sampling errors in its data systems. Such a study has never been conducted and could have meaningful effects on all classes of mail, and on the Postal Service's ability to meet competition effectively.

4. Unexplained increases in cost of flats processing. In the early 1990's, despite advances in automation, unusually rapid increases in mail processing costs for Periodicals and other flats were measured by the Postal Service, but no satisfactory explanation was provided. In Docket No. R97-1, the PRC found the trend disturbing and urged the Postal Service to make "a more systematic inquiry" into the causes.

Unified in their concern, members of the publishing industry pressed the Postal Service to initiate such an inquiry and volunteered to be a part of the process. As a result, a Joint Industry/USPS Periodicals Review Team was formed in the fall of 1998. At their own expense, seven mailers and an

approximately equal number of postal representatives visited 16 postal facilities accounting for 14 percent of the flats processing in the United States. They analyzed operations, compared facilities, and wrote a report, which was filed as a library reference in the next rate case. The report contained 15 key recommendations and became a guide to efforts to bring the costs under control. Along with this report, the Postal Service developed a "Strategic Improvement Guide for Flats Mail Processing." These inquiries did not solve all of the problems, but the Review Team brought the parties together, brought attention to the problem, and laid a foundation for further work. Without the review of the rate process and the support of the PRC, it is doubtful that the Review Team would have been formed.

5. Carrier cost study. The analysis of carrier costs is among the most complex of all analyses supporting rates. Given the magnitude of carrier costs, it also is highly important. Yet some critical inputs to the analysis are from 10 to 15 years old, a period over which the work of the carriers has changed substantially. In Docket No. R2000-1, the Postal Service proposed to use a new study to replace the older analysis. That study received a great deal of criticism from interested parties and by the PRC. In the end, the PRC rejected the new study for reasons associated with how the data were collected and used. In late 2003, the Postal Service presented the PRC with a new study of carrier costs. This study has the capability to improve the tracing of costs to

the classes of mail. It is clearly important that it be critically examined and evaluated in a future case.

C. Innovation/Worksharing

Without doubt, the most important innovation in rate setting since Postal Reorganization has been the recognition of mailer worksharing. As a user of Standard ECR Saturation Mail, Valpak is among the mailers that take maximum advantage of worksharing opportunities.

Discounts are given for mail that has been pre-processed by the mailers, and mailers' agents. When mailers do the processing (or some other work element) at a lower cost than the Postal Service, the efficiency of the nation and the welfare of the mailers are improved. But few mailers would do the additional work without being offered discounts.

Beginning in 1976, a small discount was offered in First-Class Mail. Since then, and continuing today, both the number and size of such discounts have grown. Today, there are over 200 distinct worksharing discounts. The worksharing program in the United States is regarded world-wide as a model of improved efficiency in meeting mailer needs and in helping to develop an effective postal industry.

The worksharing success story began principally in the minds of large mailers, who were doing extra work to prepare their mail and knew that they could do this work more cheaply than the Postal Service. The Postal Service

offered "one size fits all" rates, and saw no reason to reward those mailers who did additional work. After Postal Reorganization, these mailers fought to have their worksharing recognized by the rate process. The Postal Service opposed it, but the response from the PRC was positive. Faced with this response and being interested in avoiding conflict with its largest customers before the PRC, in 1973, the Postal Service proceeded to propose the first worksharing discount for First-Class Mail. The PRC approved it and encouraged further steps. In many cases, the discounts recommended by the PRC have been larger than those proposed by the Postal Service, often aided by technical analysis submitted by mailers. On some occasions, the PRC has approved worksharing discounts that were proposed by mailers, not by the Postal Service. Without the rate process and the associated review by the PRC, in Valpak's view, it is doubtful that the mailing industry would be where it is today.

D. Correction of Errors

The review process before the PRC has helped to surface and correct numerous errors in the Postal Service's data and information systems. Without this adversarial ratemaking process, and the Commission's responsibility to scrutinize the record evidence, the errors likely would have continued to lay dormant much longer. Here are some recent examples:

1. In-County Periodicals. In Docket No. R94-1, the usual rate development process resulted in a proposed increase of 34 percent for In-

County Periodicals. This result received a great deal of attention. During the case, the Postal Service found that one of its data systems had failed to receive a needed adjustment some years earlier. This adjustment helped result in a rate decrease of 1 percent, rather than a 34 percent increase. Without the pressure and review of the rate proceeding, it is not clear that this problem would have been resolved, at least not within a short time frame.

2. Business Reply Mail. Also in Docket No. R94-1, a special cost study showed higher costs for the Business Reply Mail Accounting System and the Postal Service proposed a 200 percent rate increase in the per piece rate, from 2 cents to 6 cents. Under review, the cost study was revised repeatedly. In the end, the PRC decided that the cost estimates were so defective that they could not be relied upon, and left the rate at 2 cents. Business Reply Mail is used heavily by many businesses and is a success story for the Postal Service. Excessive rate increases for this important service undoubtedly would have a negative effect on the Postal Service and the economy.

3. Non-machinable Parcel Post. Docket No. R94-1 also showed a very large increase in the cost for non-machinable Parcel Post, which resulted in a proposed rate increase of 28 percent. Following a question by the PRC, the Postal Service discovered a programming error in one of its data systems, which, when corrected, reduced the increase to 8.7 percent.

4. Science-of-Agriculture publications. In Docket No. R97-1, the PRC found that the Postal Service had inadvertently omitted the weight of Science-of-Agriculture publications from the distribution of Periodicals transportation costs. (The adjustment required in this case was reasonably small, but it points to the kinds of errors that outside review can uncover.)

5. Periodicals dropship discounts. A Presiding Officer's Information Request in Docket No. R97-1 led the Postal Service to reduce its dropship savings estimate for Periodicals by 60 percent. This made a meaningful difference in the dropship discounts for Periodicals, and also decreased the rates for small mailers who do not dropship.

6. Special handling fees. In Docket No. R97-1, the Postal Service proposed a 200 percent increase in the fee for special handling, from $5.40 to $17.25 for pieces up to 10 pounds, based on a finding that unit costs had tripled. Rate case litigation raised serious questions about the accuracy of the costs. The PRC concluded that it could not rely on the costs and recommended no change in the rates. The Postal Service said it might study the costs further in the future. This rate is used extensively for science and agricultural purposes. A substantial increase in the fee could have had a large negative effect on the industry.

7. Letter-flat differential. In Docket No. R2000-1, Valpak investigated the reason underlying peculiar changes in the difference in cost between letters

and flats in Standard Mail. The PRC found that "there is a mismatch between IOCS costs and RPW volumes related to letters and nonletters." *Op. & Rec. Dec.*, Docket No. R2000-1, para. 5547. Subsequently, the Postal Service has indicated that it is taking steps to fix the mismatch.

8. Media Mail. Media Mail includes books and non-library materials, both categories that in the past have been the recipient of special attention and preferred rates from Congress. In Docket No. R2000-1, the Postal Service request indicated that its costs had increased for reasons that, even after examination, remained unexplained. In an unusual procedure, the PRC ordered the Postal Service to investigate these rising costs. The result was a special piece of Postal Service testimony that admitted to costing problems and demonstrated that 12.6 percent of the associated mail processing costs should have been reassigned to another subclass.

9. Registered Mail. In Docket No. R87-1, the Postal Service proposed an increase of 35.3 percent for Registered Mail, an increase so large it would have done much to destroy this important product. Upon investigation, it turned out that certain costs were classified incorrectly by the Postal Service, which resulted in the PRC granting an increase of only 10.3 percent.

II. THE TIME AND COST OF LITIGATING RATE CASES COULD BE REDUCED WITHOUT LEGISLATION

A. Charges Made Against Ratemaking System

Among the major motivations underlying Postal Reform is the widespread belief that PRC ratemaking takes far too long (usually claimed to be 18 or more months) and is far too expensive (usually described as "millions" of dollars).

This complaint once was voiced loudly by former Postmaster General Marvin Runyon, who also was aghast that the Postal Service did not have the unilateral right to set whatever rates it wanted, even though it has a statutory monopoly over most products. He was offended that the Postal Service was required to submit requests for rate increases to the PRC, defend them in an adversarial process, and await the PRC's recommendation. He resented the Postal Service spending money on the preparation of rate cases, and the concept of the Postal Service being under the ratemaking authority of the PRC.

Since then, the "too long/too expensive" mantra has been repeated by many mailers, including some with no actual experience in rate case litigation before the PRC. These accusations should not be accepted blindly, but should be examined critically. And when examined, it becomes evident that the process is relatively expeditious and relatively inexpensive. To the extent that it is complex and lengthy, it is made so primarily by deliberate decisions of the Postal Service. For this reason, the "too long/too expensive" argument does not justify radical experimentation designed to free the Postal Service from the

"shackles" of the PRC. Both the time and expense required to litigate a rate case could be reduced, perhaps rather dramatically, at the unilateral discretion of the Postal Service, without any legislation whatsoever.

B. Reducing the Time Required

Claims that the ratemaking process takes 18 or more months are rarely explained. Even in an omnibus rate case, in which new rates for all products are set, by statute, the PRC must issue an Opinion and Recommended Decision within 10 months of the day the Postal Service files a request for increased rates (39 U.S.C. Section 3624(c)(1)). The PRC has never violated its duty to issue a timely Opinion and Recommended Decision, but some have been issued more expeditiously than others.[1]

1. Timetable for PRC omnibus rate cases. The first couple of months of an omnibus rate are spent studying the Postal Service's request and conducting written discovery concerning it. This is followed by oral cross-examination of Postal Service witnesses, submission of testimony by intervenor mailers and mailer associations, written discovery to those intervenor witnesses, and oral cross-examination of those intervenor witnesses. Discovery

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[1] Not all rate cases have taken even the full 10 months. In Docket No. 2001-1, the Postal Service filed its request, along with a request for expedition, with the PRC on September 24, 2001. In response to the request of the PRC, the Postal Service and the intervenors were able to negotiate a settlement, and the PRC issued its Opinion and Recommended Decision on March 22, 2002, less than six months after the request was filed. The Postal Service implemented the higher rates on June 30, 2002.

against intervenor witnesses is followed by rebuttal testimony by the Postal Service and those who support its position, and oral cross-examination with respect to those new pieces of testimony. Presentation of the case concludes with initial briefs and reply briefs. (Oral argument has fallen into disfavor and is rarely used.) After briefing, the PRC deliberates for a few weeks and issues its Opinion and Recommended Decision. Then, the Board of Governors usually takes a month to consider its options, and at least another month of notice to mailers of the increases, for a total of about 12 months, from request to implementation of new rates.[2]

Any mention of a time period in excess of 12 months must include the time the Postal Service takes to formulate its rate case, but much of that is within its own power. Certainly, even if the Postal Service had the authority to set at least some of its own rates, it would conduct cost studies, engage in rate design activities, and replicate many of the steps necessary to prepare for a rate case. If the Postal Service had the authority to set at least some of its own rates and chose to shortcut that process, it would be a warning sign that decisions were being made for arbitrary reasons.

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[2] Each time the Postal Service implements new rates, stamps have to be printed and distributed to a supply chain that includes tens of thousands of post offices, as well as grocery stores, ATMs, stamp dispensing machines, etc., and every bulk mailer must re-program and update its computer system to accommodate the new rates.

If the scope of omnibus rate cases is to remain the same, the only way that this 10-12 month period could be shortened significantly is by compromising the procedural due process rights of intervenors, and reducing the ability of the adversarial process to challenge the representations of the Postal Service in an effort to unearth vital information.

2. Postal Service now chooses to file complex cases. It actually is possible that the scope of these omnibus rate cases could be reduced to focus exclusively on rate-related issues. Complex costing issues could be decided in a separate proceeding. Classification issues could be decided in still a different proceeding. But the Postal Service has resisted requests to limit rate cases to litigating rate increases.

As an example of delays caused by the Postal Service in the rate-setting process, in Docket No. R97-1, the PRC noted that "[t]he Postal Service's decision to file certain studies and their results, detailed data, and other information on which its proposals rely as library references — rather than as testimony or exhibits sponsored by its witnesses — has significantly complicated the procedural course of this docket." *Op. & Rec. Dec.*, Docket No. R97-1, para. 1005. As a result, the PRC had to delay the procedural schedule by six weeks to allow time for additional discovery and hearings. *Id.*, para. 1012. Nevertheless, the PRC was able to meet the statutory 10-month deadline.

To shorten dramatically the time required to litigate a rate case, the Postal Service would need to focus solely and exclusively on (i) its required revenue, and (ii) the rates that it proposes to satisfy the revenue requirement. Instead of such focus, omnibus rate cases filed by the Postal Service inevitably contain a plethora of classification and methodological issues that has increased exponentially the complexity of these cases. A great deal of the voluminous testimony and library references that have been filed with previous rate cases pertained not to rates, but to those other ancillary issues. Yet none of those other issues, or related testimony, or supporting documentation, are necessary to establish the revenue requirement and to recommend rates sufficient to meet the revenue requirement.

Without all of this excess baggage from non-rate issues, **an omnibus rate case restricted solely to rates could probably be completed in roughly five to six months**, or about half the litigation time required for a "usual" rate case. The effort required to prepare such a case by the Postal Service would be reduced commensurately. The only reason that this is not done is that the Postal Service seems to prefer to file a more complex than necessary case that contains classification proposals, as well as technical methodology alterations. However, the Postal Service must not be allowed to use that complexity, and the time and cost expended by mailers availing themselves of the right to question that filing, as an excuse for reform.

3. Postal Service now chooses to avoid transparency. A second manner in which rate cases could be made shorter is by allowing the Postal Rate Commission and mailers to have advance access to the data now filed by the Postal Service only at the time an omnibus rate case is initiated. Unfortunately, here too, the reason cases must take 10 months must be laid at the door of the Postal Service. The Postal Service has resisted periodic filing of its data with the PRC. For example, in PRC Docket No. RM2003-3, a recent rulemaking docket on periodic reporting of Postal Service data, the final filing by the Postal Service threatened that it simply would not comply if the PRC issued an order requiring it to provide more information between rate cases. Substantive Comments of the United States Postal Service, p. 30. The GAO has criticized the Postal Service for its resistance to transparency, but the problem remains. Statement of Comptroller General Walker to the Senate Committee on Governmental Affairs, November 5, 2003, pp. 19-23.

4. Productivity avoids rate cases. Even if the Postal Service declines to do that which is in its power to simplify omnibus rate cases, such cases need not occur frequently. If Congress enhances Postal Service management's authority to control its infrastructure, and to adjust it relative to mail volume, it would allow the Postal Service to be more productive and control costs better. If a rate case were needed only once every four years or so, as would be the case if the Postal Service were allowed to increase its productivity and restrain

costs better, then in that context, a 6-month, or even a 10-month, rate case would seem far less onerous.

C. Expenses In Perspective

Advocates of changing the ratemaking process decry how expensive the current ratemaking process is for mailers. Most assertions that rate cases are "expensive" tend to be short on details, however.

A total of 12 omnibus rate cases have been filed in the 33 years since the Postal Reorganization Act became effective. This means, on average, that an omnibus rate case has been filed once every 2.75 years (or 2 years and 9 months). In FY 2003, the Postal Service had revenues of $68.5 billion. At this rate, over a rates-in-effect period of 2.75 years, total Postal Service revenues approximate $188 billion. The cost of litigating a rate case for the Postal Service would be almost impossible to separate from the other costs of maintaining personnel and programs, and any estimate would likely be quite inclusive. The cost of litigating a rate case for mailers is unknown, but with about 70 intervenors, many of whom only intervene nominally, the combined cost is probably on the order of magnitude of $20 million. Thus, the cost of litigating a rate case amounts to slightly more than one one-hundredth of one percent of Postal Service revenues, an almost microscopic amount.[3]

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[3] Congressional opposition to closing unnecessary retail and mail processing facilities imposes an annual cost on mailers of at least $1 billion, and possibly as much as $3 billion or more. Congressional support for every

Mailers who complain about the cost of ratemaking litigation before the PRC are not forced to litigate. It seems clear that they spend money to defend their position because they believe they have a story to tell. If there were no ratemaking litigation, is it likely that these mailers would eliminate spending on trying to affect the rates that they pay? Actually, it is more likely that mailers would spend great sums on trying to convince the Postal Service and its Board of Governors of the rightness of their positions, just as they now try to convince the PRC. Shifting this energy and spending into the nonpublic setting of lobbying the Postal Service could have unwanted results. Litigating one's case before a neutral, independent agency in the full light of day has much to be said for it.

D. Repealing the Governors' Current Limited Authority to Set Rates

The PRC's decisions need to be final and binding on the Postal Service, with no veto power by the Governors. The basic statutory scheme is that the PRC "recommends" rates, which are normally accepted and implemented by the Governors. However, the statute provides one unusual circumstance in which the Board of Governors may raise postal rates without the concurrence of the PRC.

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facility, no matter how obsolete and unnecessary to the Postal Service's obligation to provide universal mail delivery, forces mailers **each year** to pay 50 to 150 times the $20 million cost that recurs once every 2.75 years. It is with respect to controlling its physical infrastructure that the Postal Service needs flexibility, far more than with respect to the rate-setting process.

The Governors[4] have the option to accept the PRC's recommended rates, or reject them, or allow the rates to be implemented "under protest." If they are rejected and sent back to the PRC for a "Further Recommended Decision" and the PRC still recommends unacceptable rates, the Governors may unilaterally set whatever rates they want — if they meet three criteria: (i) act unanimously, (ii) determine that their modification of the rates "is in accord with" the record of the PRC's proceedings and the Postal Reorganization Act, and (iii) determine that the PRCs recommended rates will not provide sufficient revenues. The Governors have exercised this provision, sometimes called the "anarchy clause," to modify rates on only three occasions: Docket No. MC78-2 (a mail classification case affecting commercial and nonprofit advertising mail); Docket No. R80-1 (an omnibus rate case); and Docket No. R2000-1 (an omnibus rate case).

This statutory "anarchy clause" conflicts with fundamental principles underlying the Postal Reorganization Act. Federal courts have observed that the structure of the Act (and its amendments) reflected Congressional fears of allowing the Governors to control revenues, and of their usurpation of control

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[4] The Act distinguishes between actions by the "Governors" — the nine appointed Governors — and the "Board of Governors," which includes the Postmaster General and Deputy Postmaster General. *See* 39 U.S.C. Section 102. For example, the Governors — but not the Board of Governors — are empowered to approve or reject a Recommended Decision from the Commission. 39 U.S.C. Section 3625.

over rates from the PRC.[5] However, the courts have imposed very few limits on the Governors' power to modify under the anarchy clause, although they recognize that mailers' due process rights are sharply circumscribed when the Governors take such unilateral action.[6] Although the absolute limits of that power have not been firmly established, many believe that the practical difficulties involved in challenging its exercise allow the Governors excessive power to trump the entire ratemaking process, which power is inconsistent with the fundamental ratemaking procedure established in the Act.

Fortunately, certain legislative proposals to amend the ratemaking process in the Postal Reorganization Act (*e.g.*, Mr. McHugh's H.R. 4970 (2002)) would repeal the anarchy clause.

E. Summary

To sum up, the current ratemaking process established by the Postal Reorganization Act has worked reasonably well. In fact, it may be the part of the Act which has worked the best. It is Valpak's view that excessive focus on the ratemaking process has diverted attention away from the real problems faced by the Postal Service.

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[5] United Parcel Service v. USPS, 604 F.2d 1370, 1373 (3rd Cir. 1979); United Parcel Service v. USPS, 615 F.2d 102, 108-10 (3rd Cir. 1980).

[6] *See* National Easter Seal Society v. USPS, 656 F.2d 754 (D.C. Cir. 1981); Time v. USPS, 685 F.2d 760 (2d Cir. 1982); Time v. USPS, 710 F.2d 34 (2d Cir. 1983).

III. THE IMPORTANCE OF PROPER PRICING FOR WORKSHARING

As indicated previously, Valpak's mail is highly workshared. Valpak has supported and participated in virtually all Standard Mail worksharing innovations to date, and feels that further progress is possible. As discussed in more detail below, Valpak proposes a legislative framework to deregulate worksharing activities and services. The approach proposed here would give the Postal Service considerably more flexibility and latitude, which it could use to promote worksharing.

It appears that some would like for Congress to use postal reform to impede worksharing. If agreed to, such a short-sighted result could do grave damage to not only mailers, but the Postal Service as well. Valpak strongly opposes any statutory limits designed to restrict the size or scope of worksharing incentives and options.

The Postal Service currently undercharges for processing and transportation and makes up for those losses by overcharging for delivery. Such a result would be cured by a move to bottom-up costing, which Valpak has supported for many years. In fact, the concept has been advanced most consistently by Dr. John Haldi, a postal economist who has appeared as an expert witness for Valpak before the Postal Rate Commission.

A. Pitfalls and Problems with Proposed Legislative Restraints

A postal reform bill (S. 1285) was introduced by the Senator Thomas Carper (D-DE) on June 18, 2003. Section 3623(i) of that bill contains a provision that prohibits rate discounts for the preparation, processing, or transportation of mail that exceed costs avoided by the Postal Service by virtue of the additional functions performed by the mailer. To appreciate the myriad pitfalls and problems that can arise from a provision of this type, a brief introduction is necessary. A worksharing "discount" is the difference between two rates. For example, the current rate for a Standard ECR Saturation letter entered at an originating facility is 19.4 cents. If the same letter is entered at a destinating Bulk Mail Center, the rate is 17.3 cents. The difference between the two rates, 2.1 cents, is often referred to as a discount.

Although rate schedules sometimes make explicit references to discounts, rates can easily be displayed without any such reference. Table 1 shows the complete set of rates for Standard ECR letters in two different formats. Part A displays rates two different ways. The rates for preparation level (density/presort) are shown without any reference to "presort discounts," although the differences in the rates are often referred to as such. Rates for different destination entry points are displayed using discounts. Part B shows all possible ECR letter rates without any reference to discounts. In Part B, the rates simply "are what they are." The rates in Parts A and B are identical.

Table 1

Enhanced Carrier Route Letter Rates

A. Using Discounts

	Rate
Piece Rate	
Basic	$0.194
High Density	0.164
Saturation	0.152
Automation Basic	0.171
Destination Entry Discounts	
BMC	0.021
SCF	0.026
DDU	0.032

B. Without Using Discounts

	Destination Entry			
Preparation Level	None	BMC	SCF	DDU
Basic	0.194	0.173	0.168	0.162
High Density	0.164	0.143	0.138	0.132
Saturation	0.152	0.131	0.126	0.120
Automation Basic	0.171	0.150	0.145	0.139

A surcharge is also the difference between two rates. For example, the rate for an ordinary one-ounce First-Class letter is 37 cents, and the rate for a one-ounce "non-standard" letter is 49 cents. In this instance, the difference between the two rates, 12 cents, is referred to as a surcharge.

Discounts and surcharges are both examples of rate differences, or "rate differentials." A discount easily can be turned into a surcharge (and vice versa). To illustrate, in Table 1, the rate for a Basic letter is 19.4 cents, and the rate for a High Density letter is 16.4 cents. The difference of 3.0 cents could be considered a discount from the Basic rate, but one could just as easily consider it to be a surcharge on the High Density rate. Examples of both discounts and surcharges can be found throughout the current rate schedules.

One difference between discounts and surcharges is that discounts are usually set on the basis of **costs avoided**, while surcharges usually are set on the basis of **costs incurred**. If **costs avoided** are always equal to **costs incurred**, then no meaningful difference exists between the two. If the two are not equal, however, that raises some challenging issues for language such as that found in the Carper bill. Analysis of **costs avoided** lacks accountability. **Costs avoided** are not recorded anywhere in the Postal Service's accounting or information systems. Hence those systems cannot even begin to substantiate whether **costs avoided** in any fiscal year were substantially more than, substantially less than, or approximately equal to the worksharing discounts received by mailers.

For certain subclasses, the rates customarily are shown without any reference to discounts or surcharges. For example, rates for Priority Mail and Parcel Post are displayed in tables that show the rate for each weight to each

zone. These rates "are what they are," just as is the case for the rates displayed in Table 1, Part B. For any given weight, the rate from a lower zone to a higher zone reflects (i) the **costs incurred** by the Postal Service to transport mail over a longer distance, plus (ii) a markup over cost (historically, the markup in Parcel Post has been rather low, and the markup on Priority Mail has been rather high). That difference also reflects costs that the Postal Service would avoid if it did not have to transport mail so far.

With the preceding as background, following are some questions that arise from the language contained in Section 3623(i) of the Carper bill, S. 1285.

> "(i) RATE DISCOUNTS- In the administration of this section, the Postal Regulatory Commission shall not permit rate discounts for additional mail preparation, processing, transportation, or other functions that exceed the costs avoided by the Postal Service by virtue of the additional functions performed by the mailer. Such discounts are allowable only if the Commission has, after notice and opportunity for a public hearing and comment, determined that such discounts are reasonable and equitable and are necessary to enable the Postal Service, under best practices of honest, efficient, and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States consistent with the service standards established under section 3691."

- Since rate differentials expressed as surcharges could, with little difficulty, be expressed as discounts, does the language in Section 3623(i) apply to surcharges?

- If Section 3623(i) does apply to surcharges, does it mean that:

- Surcharges must be less than or equal to costs incurred?
- Surcharges must be greater than or equal to costs incurred?

- If Section 3623(i) is not applicable to surcharges, does that mean that the Postal Service can avoid completely any prohibition in Section 3623(i) by simply converting discounts to surcharges when quoting or displaying rates?

- Does the above-cited language apply to any rate differentials (in particular those rate differentials that reflect transportation costs) contained in the rate schedules for Parcel Post and Priority Mail?
  - If not, why not?
  - If so, then within Priority Mail must rate differentials between zones, which now reflect transportation cost **plus a substantial markup**, be not more than the Postal Service's cost of transportation?[7]

- Suppose the Postal Service were to quote rates for First-Class Mail, Periodicals, and Standard Mail in a manner similar to the complete tables of rates for Parcel Post, Priority Mail, and certain other subclasses. That is, within each subclass, the rates "are what they are," without any references to discounts or surcharges. Would Section 3623(i) then apply? If so, how?

- Are costs avoided equivalent or equal to costs incurred?

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[7] Within Priority Mail, rate differentials between zones currently reflect full transportation cost plus a substantial markup.

- If so, does Section 3623(i) mean that rate differentials cannot be less than costs incurred? Or does it mean that rate differentials must be less than costs incurred?

- If costs avoided are not equal to costs incurred, what applicability, if any, does Section 3623(i) have with respect to costs incurred?

- Suppose the provision in Section 3623(i) were challenged in court. That is, suppose some party asserted that Postal Service discounts exceed costs avoided.

  - Since accounting records are of no help, what type of evidence would be proffered to support the challenge?

  - What level of proof would the court require in order to determine whether specific discounts, or all discounts in aggregate, do or do not exceed costs avoided?

B. Deregulation of Worksharing Activities

Worksharing has grown over the years to encompass a wide range of mail preparation activities designed to reduce the Postal Service's cost to deliver the mail. Worksharing now includes activities such as meeting address hygiene standards, sorting, barcoding, containerizing, and transporting mail. These activities essentially represent a transfer to the private sector of work that otherwise would be performed by the Postal Service. This means that mailers and third-party vendors who perform worksharing activities (i) **partner with**

the Postal Service for delivery, but also (ii) **compete with** the Postal Service for mail preparation.

In addition to the many mailers who perform worksharing activity in-house, the worksharing industry now includes a myriad of firms such as presort bureaus, third-party consolidators, software vendors, printers, and letter shops. Worksharing discounts currently amount to approximately $15 billion annually, and it is estimated that worksharing reduces the Postal Service's costs by at least that much each year. Viewed from this perspective, only two classes of mail, First-Class and Standard, have revenues that exceed the value of the independent worksharing industry. Collectively, mailers and third-party vendors engaged in postal worksharing now could be viewed as a multi-billion-dollar-a-year industry, with tens to hundreds of thousands of employees. Significantly, no economies of scale or other entry barriers are associated with worksharing activities. Consequently, firms that compete in the worksharing industry are highly competitive.

The $15 billion worth of economic activity performed by mailers and the worksharing industry substantially exceeds the Postal Service's revenues from each of the following subclasses: Periodical Mail, Media Mail, library mail, Bound Printed Matter, Express Mail, Priority Mail, and Parcel Post. The worksharing industry could be viewed as a separate industry, existing within each postal product. As a separate industry, it would be possible for legislation

to recognize explicitly that the outputs and services provided by the Postal Service to compete with these mailers and other firms engaged in worksharing activities constitute separate postal products, similar to the classes and subclasses of mail. That is, the definition of "postal product" could be expanded to give explicit, separate recognition to worksharing activities and services.[8] For any classification scheme that distinguishes between competitive and market-dominant products, worksharing services should be classified as competitive activities and products,[9] and hence should be explicitly included among the activities that fall outside the scope of the postal monopoly.[10]

This novel idea of treating worksharing as a product helps illustrate problems with the current system, where the Postal Service undercharges for workshared activities and overcharges for delivery, as discussed below. Let us consider further how such a system would work.

Classifying worksharing activities and services as competitive products would mean that, within all market-dominant bulk subclasses (First-Class

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[8] *See, e.g.*, Title I, § 101 and Title II, § 3631, of Mr. McHugh's 2002 bill (H.R. 4970).

[9] *Id.*

[10] *See* Title III, § 304 of Mr. McHugh's 2002 bill, which should be retained. This section, which subjects all Postal Service activities outside the postal monopoly to federal antitrust laws and unfair competition prohibitions and eliminates sovereign immunity protection from suits in federal court for violations of federal law, would override in part the recent decision by the Supreme Court in Flamingo v. U.S. Postal Service, 124 S.Ct. 1321 (2004).

single-piece mail and other "Aunt Minnie" mail are not bulk mail, and hence would be excluded), the Postal Service would establish separate, additional fees for any transportation and mail processing services which it provides, in accordance with a provision such as that contained in Title II, Section 3633, of Mr. McHugh's 2002 bill (H.R. 4970). This would give the Postal Service the flexibility and freedom to set fees for its worksharing activities, subject to the proviso that within each subclass the additional fees in excess of the PRC-established rate for delivery (see below) must cover at least all attributable costs of the additional services provided. In other words, fees for these services would be beyond the purview of the PRC, whose role would be merely to ascertain that the Postal Service's fees cover their respective attributable costs. In general, the Postal Service would have a published fee schedule for all bulk mail, but it would be free to negotiate fees with mailers. Allowing fees to be established in this manner, by the Postal Service and the competitive market, would reduce the regulatory burden substantially.[11] At the same time, it would prevent the Postal Service from using its monopoly over delivery to subject suppliers of worksharing activities and services to a vertical price squeeze. It

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[11] Pricing for workshared activities (*i.e.*, "discounts") is governed generally by the principle of Efficient Component Pricing ("ECP"). From a theoretical perspective, ECP is generally considered a second-best alternative to Ramsey Pricing (which has much higher informational demands). In turn, Ramsey Pricing is a second-best alternative to competitive pricing, which requires no regulation whatsoever.

also would be in conformity with the report of the President's Commission recommendation which stated that:

> Those who can do it best and for the best price should have the job, regardless of whether the "best execution" provider is the Postal Service and its existing workforce or a private-sector company. [p. 84.]

For bulk mail within each subclass that is market dominant, the PRC would establish a uniform rate for delivery of the various products (*e.g.*, letters, flats, parcels). The rates for delivery would be set by the PRC at a level sufficient to cover all of the Postal Service's institutional costs and all attributable costs that are not recovered by rates for competitive products and services. The PRC would set rates for delivery using all the criteria contained in Section 3622 of the Act.

Support for such an approach can be found in a recent study by two postal consultants to Valpak that partitioned the Postal Service's revenues into two parts: (i) revenues attributable to worksharing services (mail processing and transportation), and (ii) revenues from providing all other services, including delivery and retail, as well as institutional costs.[12] Comparison of the Postal Service's revenues from its worksharing services with the attributable

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[12] John Haldi and William J. Olson. 2003. "An Evaluation of USPS Worksharing: Postal Revenues and Costs From Workshared Activities," in *Competitive Transformation of the Postal and Delivery Sector*, edited by Michael A. Crew and Paul A. Kleindorfer. Boston, Mass.: Kluwer Academic Publishers. http://www.wjopc.com/site/publications/Compare.pdf.

costs for those activities indicated that **costs exceeded revenues by several billion dollars**. In other words, when competitive worksharing services are viewed separately, the Postal Service is providing them below their attributable cost. The deficit from providing worksharing services below cost is offset by higher rates for delivery charged to those mailers who do extensive worksharing. Requiring that the fees charged by the Postal Service for its competitive worksharing activities at least cover their respective attributable costs would help eliminate intra-class cross-subsidies.

C. Bottom-Up Costing

Although this issue may not be part of postal reform legislation, the manner in which costs are developed can have an effect on how rates are set. The use of bottom-up costs rather than top-down costs is a preferable costing method to set rates. This concept, which has received support from several mailers in testimony, is discussed in a new paper, "Postal Pricing: Top Down Discounts versus Bottom Up Surcharges" (*see* http://www.wjopc.com/site/postal/index.html). This costing approach presents a somewhat different solution to the problem of overcharging for worksharing services set out above. However, it is within the authority of the Postal Rate Commission to implement bottom-up costing, and it is likely that this will be one of the main issues in the next omnibus rate case. The most important point is that the PRC's ability to move to bottom-up costing must not be impeded by legislation.

IV. INADEQUACY OF POST-RATE REVIEW

Some proposals which would give the Postal Service greater authority to set some of its rates would provide for review by an independent body only after rates are set. Valpak believes that post-rate review, triggered by complaints filed by mailers, provides mailers with inadequate protection from abuses from any type of Postal Service rate setting.

Complaints can be expected to be filed only by mailers with a substantial financial interest in reversing a set of rates imposed by the Postal Service. There may be no mailer who has the type of financial interest required to take the initiative to retain postal lawyers and economists quickly to develop a case on short notice, and assume the burden of proof to overturn that which the Postal Service has done. Often, weaknesses in proposed rates are not seen for months during the litigation of an omnibus rate case. Few mailers could be expected to invest the funds necessary to investigate to find the hidden grounds needed to file a complaint.

A. Current PRC Complaint System

A review of current law helps understand how various proposals might operate. Currently, federal regulations allow for "rate and service" complaints to be filed with the Postal Rate Commission by persons and entities against the Postal Service, and they have so provided for the past 33 years. *See* 39 U.S.C.

§ 3662; 39 CFR §§ 3001.81-3001.87. As a practical matter, however, the types of matters that can be brought before the PRC are quite restricted in scope. And the PRC's ability to order the Postal Service to provide any meaningful relief to disaffected mailers is virtually non-existent. In fact, of the many complaints filed by mailers over the past 30 years, **none** appears to have resulted in obtaining any meaningful relief.

If we were to characterize the Postal Service's approach in defending against rate and service complaints under Section 3662, it would be either that the PRC lacks jurisdiction to grant any of the requested relief, or that the PRC should decline to exercise its jurisdiction to grant any of the requested relief. It is difficult to find a complaint case where those arguments have not been made by the Postal Service. The Postal Service appears to believe, correctly, that the current complaint provision in the law is meaningless, as the PRC has no meaningful jurisdiction to order the Postal Service to do anything.[13]

Although the postal reform bill may provide remedies such as those suggested by the President's Commission which would give new powers to the PRC, we do not think that a complaint system would ever work.

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[13] If a mailer files a complaint requesting any kind of classification change, the most successful outcome possible would be for the PRC to recommend a shell classification. The PRC cannot recommend any rates or rate changes not requested by the Postal Service. The Governors have never approved any shell classification, and they have turned down several. Any "recommendation" made by the PRC under the law, as it now stands, can be ignored by the Governors.

We have summarized a few of the complaint proceedings that have been brought before the Postal Rate Commission recently, including glimpses of the Postal Service's position vis-a-vis the complaints of dissatisfied mailers bringing such complaints and the institutional positions and remarks of the Postal Service in defending itself against such complaints.

B. PRC Docket No. C98-1.

A complaint was filed by FCA, Ltd., d/b/a Life Time Fitness ("LTF"), alleging that the Postal Service had failed to provide postal services by failing to deliver LTF's time-sensitive promotion mailings within the time the Postal Service was "committed" to delivering them, and seeking a refund of postage. Having relied upon a publicly-distributed "USPS Service Commitment Diskette" indicating that the Postal Service's service commitment for certain Standard (A) mail originating in the St. Paul 3-digit ZIP code area and destinating in certain areas within the Minneapolis-St. Paul metropolitan area "does not exceed three days," LTF was seeking to hold the Postal Service accountable for failing to live up to what the mailing community perceived as a commitment, if not a guarantee, to deliver Standard (A) mail within a certain time frame. In fact, LTF's Standard (A) mail, duly deposited with the Postal Service in early January 1998, was received by LTF customers substantially later, and the LTF promotion advertised in the LTF mail failed miserably. Some of the mail actually took three weeks to deliver. LTF alleged that it lost over $385,000 in

revenue, and also sought reimbursement of its postage cost of approximately $15,500.

LTF argued, *inter alia*, that "commitment" denotes a warranty or guaranty to perform within the stated time period. The Postal Service essentially argued that the matter in question was the type of **temporary, localized problem not** indicative of an underlying Postal Service policy problem extending **nationwide** and, as such, was not appropriate for PRC review. And even if there were jurisdiction, the Postal Service argued, the USPS "Service Commitment" diskette upon which LTF relied merely denoted the level of delivery service the Postal Service **tried** to provide, **not a guarantee**. The Postal Service argued that the PRC has no jurisdiction to grant postage refunds.

The PRC **granted the Postal Service's motion to dismiss**, stating that: (1) it has no authority over **operational** aspects of postal management, and is limited to rendering a public report on matters not related to rates or classifications; (2) the matter complained of by LTF concerned an **isolated** matter and did **not** indicate a matter involving Postal Service public policy on a **nationwide** basis; and (3) the PRC lacks the authority to grant postage refunds.

Nevertheless, the PRC also took the rather unusual step of filing a **unanimous concurring opinion**, to address its concerns with the Postal

Service's use of the term "service commitment," which it described as "an extremely inappropriate description of the Service's operational goal or the standard it tries to achieve for Standard (A) Mail...." (*Op. & Rec. Dec.*, p. 9.) The PRC then went on to **criticize this aspect of the Postal Service's operations**, essentially determining that the Postal Service's so-called service commitment for Standard (A) mail was based on conjecture, and implying strongly that the Postal Service's conduct was of a type that the Federal Trade Commission would label **deceptive advertising** if conducted by a private business. The PRC admonished the Postal Service for such conduct, and suggested that the Postal Service "should review its advertising and marketing materials in general, and particularly the pertinent language" discussed above, "with a view toward eliminating any potentially deceptive or misleading language." (*Concurring Opinion*, at 3.)

To the best of our knowledge, the Postal Service has not taken the PRC's advice over the last five years. The Postal Service's advertised "service commitment" for Standard Mail appears to be the same as that complained of by LTF.

C. PRC Order No. 1388.

The meaning of "postal service" within the intendment of 39 U.S.C. Section 3622 is an issue that has arisen in a number of proceedings over the past 25 years involving the exercise of the PRC's jurisdiction. And, particularly

during the last 10 years, as the Postal Service has moved into providing certain allegedly "non-mail" services in competition with private industry, issues as to whether such services constitute "postal services" seem to have arisen with increasing frequency. PRC Order No. 1388 helps demonstrate the difficulties posed by current law, as well as the Postal Service's standard approach when challenged about its questionable, unilateral operations.

PRC Order No. 1388 was an adverse ruling upon a petition by a mailer, an organization known as Consumer Action, to initiate proceedings to consider the jurisdictional status of 14 services provided to the public by the Postal Service without prior PRC approval. The PRC decided not to initiate a classification proceeding for several reasons, including indications from the Postal Service that it was terminating its involvement with several of the subject services, as well as issues as to whether a classification proceeding would lend itself to efficient resolution of the issues or would represent the most efficacious use of the PRC's and the parties' resources. *Id.*, at 14-15.

As the PRC noted in Order No. 1388, the Postal Service's standard approach, when confronted by such an issue, is to argue that the PRC has no jurisdiction even to consider the matter. Nevertheless, as the PRC noted, "[t]o the extent [the Postal Service] proposes to provide a postal service, the Act directs it to submit a request for a recommended decision on changes in the mail classification schedule." *Id.*, at 12. Thus, the issue of precisely what

constitutes a "postal service" looms large, and is an issue of fundamental importance to both mailers and the Postal Service. (This issue is now being explored in a rulemaking docket, Docket No. RM2004-1.)

D. PRC Docket No. C2004-1.

A coalition of major Periodical publishers/mailers, including Time-Warner, Conde Nast, Newsweek, Reader's Digest, and TV Guide, filed a complaint under 39 U.S.C. Section 3662, asking the PRC to hold hearings and issue a recommended decision making a number of changes in Periodicals rate design and structure. The Postal Service filed an Answer, claiming essentially that the complaint — which seeks an improvement over the current postal rate structure — does not establish an adequate basis for PRC jurisdiction because it does not contain a "well-grounded allegation" that existing rates are unlawful. USPS Answer, at 4. According to the Postal Service, (1) the attempt to file a rate complaint case fails because the complaint seeks to better existing rates rather than complain of their unlawfulness, and even if rates should be changed, the PRC lacks jurisdiction even to recommend such changes absent a Postal Service request for a change, and (2) the publishers are really trying to "back door" the PRC into a mail classification proceeding, with rate consequences, which, again, only the Postal Service is supposed to be able to do.

The Postal Service even advances the argument that, to the extent that a complaint is made about the existing rate structure, the complainant is limited to making that argument in an appeal, under 39 U.S.C. Section 3628, from the decision in the previous rate case establishing that structure. (Docket No. C2004-1 is still pending, and is included here to illustrate the Postal Service's predictable response in virtually any rate or service complaint.)

Clearly, the Postal Service has resisted the current complaint system, and could be expected to resist any complaint-based system that Congress could devise. This type of history of a complaint-based process helps demonstrate why Valpak finds any new complaint-based system inadequate to the task. A much better approach would be for the entire ratemaking authority to reside outside of the Postal Service.

V. PRINCIPLES FOR MEANINGFUL POSTAL REFORM

Although this testimony has focused on attempting to stop ill-advised changes in ratemaking, Valpak believes that the principal thrust of postal reform legislation should be implementing the President's Commission recommendations that require the Postal Service to focus exclusively on the delivery of the mail, and give the Postal Service all of the management tools necessary to run the company in a businesslike manner. Therefore, as we see

it, the main thrust of postal reform should be to implement the following principles.

- Require the Postal Service to focus on delivery of traditional mail, leaving electronic products and non-mail services to a well-served and innovative private marketplace.
- Entrust completely to the Postal Service the ability to make management decisions as to which retail and operating facilities stay operational, but if necessary, use a Postal Network Optimization Commission ("P-NOC").
- Allow the Postal Service to experiment with variations in service levels, including reducing the frequency of delivery from the current six days per week.
- Allow the Postal Service to upgrade plant and equipment, constantly improving the infrastructure of the Postal Service, even if this investment must be debt-financed.
- Urge the Postal Service to increase research and development spending.
- Urge the Postal Service to focus on increasing productivity.
- Urge the Postal Service to look for ways to promote worksharing.
- Allow mailers to stop paying excessive rates which overfund the Civil Service Retirement System ("CSRS") and not require that future contributions be placed into any escrow account.
- Remove from the Postal Service the burden of paying for the retirement costs associated with the military service of retired postal workers.

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